PROTECTION OF NON-ADJUSTING CREDITORS OF PRIVATE LIMITED COMPANIES IN THAILAND

BY

ADAM CHARLES REEKIE

A DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE DEGREE
OF DOCTOR OF LAWS
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ABSTRACT

This dissertation examines the legal protections available to non-adjusting creditors of private limited companies in Thailand. Non-adjusting creditors are those that cannot negotiate the terms on which they extend credit: for example, a small supplier to a large and powerful trade purchaser, or a victim of a wrongful act committed by a company. Unable to take advantage of contractual or proprietary protections, and unlikely to recover their debts through bankruptcy proceedings, non-adjusting creditors are particularly exposed to the risks of the debtor's managers and shareholders engaging in harmful behaviour: actions which illegitimately reduce the debtor company's assets or increase the risks of business failure.

This dissertation evaluates the applicable legal framework against the enlightened shareholder value normative model of corporate governance. Additionally, it performs a comparative historical analysis with English and German law to reveal the path of development of Thai law. It highlights various deficiencies in the current framework, particularly the lack of incentives or requirements for directors to consider the interests of non-adjusting creditors when they have become the company's residual claimants. The comparative analysis shows that Thai law primarily focuses on creditor protection through enforcement of criminal law.

The dissertation makes several recommendations, including the improvement of public enforcement of directors' duties through the introduction of a director disciplinary sanctions regime, to better protect the interests of non-adjusting creditors in alignment with the enlightened shareholder value model of corporate governance.

Keywords: Company Law, Creditors, Creditor Protection, Legal Capital, Directors' Duties, Shareholder Liability, Directors' Disciplinary Sanctions, Director Disqualification, Non-Adjusting Creditors

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Adam Reekie

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LIST OF ABBREVIATIONS

Abbreviation	Term
AnfG	Avoidance Act
AktG	*Aktiengesetz* [Act on Public Companies]
BA	Bankruptcy Act BE 2483 (1940)
BCA	Business Collateral Act BE 2558 (2010)
BE	Buddhist Era
BGB	*Bürgerliches Gesetzbuch* [Civil Code]
BGH	*Bundesgerichtshof*, High Federal Court of Germany
CA 2006	Companies Act 2006
CCA	Companies (Consolidation) Act 1908
CCC	Civil and Commercial Code of Thailand
CCPA	Consumer Cases Procedure Act BE 2551
CDDA	Company Directors Disqualification Act 1986
CG2017	Corporate Governance Code 2017
Cork Report	Insolvency Law Review Committee Report of 1982
DBD	Department of Business Development of the Chamber of Commerce
ESV	Enlightened Shareholder Value
EU IFRS	IFRS as adopted in the EU
FAP	Federation of Accounting Professions
GmbH	*Gesellschaft mit beschränkter Haftung* [Limited Liability Company]
GmbH Act	Act on Limited Liability Companies
HGB	*Handelsgesetzbuch* [Commercial Code]

IA86	Insolvency Act 1986
IFRS	International Financial Reporting Standards
InsO	Insolvency Code
MLCA	Money Laundering Control Act BE 2542 (1999)
MoMiG	Act to Modernise the GmbH Act and Combat Abuse
Offences Act	Act Prescribing Offences Related to Registered Partnerships, Limited Partnerships, Limited Companies, Associations and Foundations BE 2499 (1956)
Partnerships and Companies Act of 1911	Act on Partnerships and Companies, RS 130 (1911)
RS	Rattanakosin Era
Second Directive	Second Council Directive [on Company Law] 77/91/EEC of 13 December 1976
Statute of Elizabeth	Statute of 13 Elizabeth 1 of 1571
StGB	Criminal Code
TAS	Thai Accounting Standards
TTCMA	Trusts for Transactions in Capital Markets Act B.E. 2550 (2007)
UK GAAP	Financial Reporting Standards published by the Financial Reporting Council

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Companies (Consolidation) Act 1908 ("CCA")

Companies (Particulars as to Directors) Act 1917

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Limited Liability Act 1855

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Germany

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CHAPTER 1
INTRODUCTION

1.1 Background

The background to this dissertation's research topic may perhaps best be introduced with an illustration. Imagine a chain of coffee shops, operated by a limited company, that has been in business for 10 years. Suppose that the business, initially successful, has fallen on hard times due to increasing competition. Eventually, its financial circumstances may deteriorate to the point where it is unable to pay its creditors. These creditors might, as typical for such a business, include the following:

1. A bank that has provided it with loans to provide capital for the business;
2. A landlord to whom the business owes rent in relation to its premises;
3. Suppliers who have extended credit to the business in the form of goods, such as coffee beans and brewing equipment, provided on delayed payment terms;
4. Employees who are owed wages under their employment contracts; and
5. Tax authorities who are owed income tax from prior profitable periods and consumption taxes in relation to the goods that the business sells.

These creditors may all bring claims for the repayment of debts against the company operating the business. However, the circumstances under which the extension of credit has been negotiated, and the potential action that can be taken to recover the debt, may differ strikingly among the different creditors.

The law recognises a distinction between secured and unsecured creditors. The former have negotiated successfully for the debtor to grant them a proprietary interest in the debtor's assets. In the illustration above, the bank (1) might have taken security over the debtor's assets in return for agreeing to provide a loan. As discussed in more detail in this chapter, being a secured creditor brings with it many advantages

in relation to the recovery of debt, perhaps chief among which is that the assets subject to the security interest do not form part of the debtor's estate on bankruptcy. These assets may be sold, and the proceeds used solely to repay the secured creditor with any remaining funds devolving to the bankruptcy process. Thus, out of all the creditors, the bank would be in the strongest position to recover its debt from the business.

The law generally views all other creditors as belonging to the same category: unsecured creditors. However, this broad category typically includes a wide variety of different creditors, who have extended credit on different terms, and who have different options available to them if the debtor fails to repay. In reference to the illustration above, the landlord (2) may have strong contractual protections: for example, terms allowing it to swiftly terminate the lease, evict the debtor, and offer the premises to a new tenant on default in making a rental payment, combined with a guarantee from the debtor's shareholder for any losses incurred. Suppliers (3) might be composed of trade creditors with different levels of bargaining power: some might have negotiated for contractual protections through favourable contract terms, including various mechanisms of trade finance such as letters of credit or bank guarantees. Others, by contrast, might be forced to supply on the *debtor's* preferred terms and conditions due to their weaker bargaining power, providing no special protection. In the example above, if the debtor coffee chain is a large business and the agribusinesses supplying it coffee beans are small operations, it is unlikely that the suppliers will be able to negotiate contractual protections. Employees (4) are rarely able to negotiate their employment contracts, which will therefore offer no protection for their employer's failure to pay their salaries. However, specific legislative provisions may grant them a measure of priority in recovering in bankruptcy. Although tax authorities (5) likewise have no protective contractual terms, they benefit from the resources of a large institution, including personnel with expertise to assist in the recovery of debts, and, potentially, specific legal provisions including criminal penalties. Thus, from this illustration, it can be seen that the recoveries made from the failing business of the debtor will likely vary widely within this single – as it is generally recognised by the law and legal scholarship – conceptual group of 'unsecured creditors.'

As discussed further in this chapter, economics literature has further subcategorised the broad, legal category of 'unsecured creditors' into '**adjusting**' and '**non-adjusting**' creditors (with further subcategories). Adjusting creditors are those who have negotiated contractual protections, such as third party guarantees or other protective clauses increasing their chances of recovering their debts, while non-adjusting creditors are those who have not. It is on the protection of non-adjusting creditors of private limited companies that this dissertation focuses.

There are good economic and business reasons for a legal system to grant or acknowledge the priorities of secured creditors and the options available to adjusting creditors. They allow for flexibility and negotiation in the terms of credit. Putting it simply, a company may be able to borrow at a lower interest rate if security, or other protective measures, are offered to the creditor as a part of the bargain. Furthermore, business failure in any economy is inevitable, and the consequences of that failure must fall on someone where there are insufficient assets to repay every creditor. This dissertation does not aim to investigate ways to ensure that every non-adjusting creditor is fully repaid in all circumstances, or that non-adjusting creditors are repaid in priority to secured creditors. The former would be unfeasible, and the latter would surely cause wide-ranging unwanted consequences for the economy and present a significant restriction on legal norms relating to freedom of contract. Rather, this dissertation's objective is to investigate whether non-adjusting creditors are left exposed to abuse following the extension of their credit, resulting in a lower recovery than ought to be the case, and, if so, whether the law can play a part in preventing this. The prevention of such abuse would, it is suggested, have a number of positive effects on the economy, through protecting the businesses of non-adjusting creditors, their credit quality, their employees' job security, and their own creditors' prospect of debt recovery.

Therefore, it is to the behaviour of the debtor company that the attention of this dissertation will generally turn. Abusive behaviour on the part of the debtor company, particularly in the period prior to formal insolvency proceedings, may result in a reduction in the recoveries of non-adjusting creditors. There are incentives, recognised in economics literature, for managers and shareholders to engage in this behaviour, which can, as discussed below, be generally placed into three categories –

asset dilution, asset substitution, and debt dilution. To briefly relate this to the illustration above, where the coffee shop chain business encountered financial difficulties, managers and shareholders of the debtor company might be tempted to borrow excessively to keep the business running, in hope of returning to better fortunes ('debt dilution'). Alternatively, they might sell the business' assets and use the proceeds to start a different business activity with much higher risk, but greater potential returns, in a desperate attempt to return to profit ('asset substitution'). Finally, realising that there is no hope for the business to recover, they might be tempted to transfer any remaining funds to the shareholders and abandon the company to the inevitable bankruptcy and liquidation process ('asset dilution'). In all these situations, the creditors, as a group, would likely suffer a reduction in the amount of debt recovered.

Secured creditors, as discussed below, are unlikely to be affected by such abuse, since it, or its impact, is usually prevented by their security interest. Adjusting creditors either negotiate for means of protection, such as guarantees, or are able to address the abusive behaviour through restrictions in contractual clauses. By contrast, due to their subordinate position on insolvency and lack of contractual or proprietary protection, non-adjusting creditors are the group affected first and foremost by any reduction of the debtor company's assets, increase in its risk profile, or assumption of additional debt.

The extent to which behaviour should be considered 'abusive' to non-adjusting creditors, or resulting in recovery lower than 'ought' to be the case, must rest on principled foundations, discussed in some detail in this chapter. It is not argued simply that non-adjusting creditors should be protected because they are in a vulnerable position. Indeed, some creditors may be very powerful but may choose to be in the position of non-adjusting creditors as a negotiated position, taking higher risk for higher potential return. Rather, the principled basis on which a company's managers and shareholders are considered to benefit themselves *illegitimately* at the expense of creditors – with particular impact on the non-adjusting creditors – must be determined.

This background section will proceed as follows. First, it will go into some detail on the concepts of different types of creditors, which includes both the

distinction recognised in law – secured and unsecured – and other subcategories of unsecured creditors discussed in economics literature. Then it will discuss the vulnerabilities of non-adjusting creditors in Thailand: their position on insolvency and the abusive behaviour on the part of the debtor arising from incentives created by fundamental features of the limited company form. Finally, it will discuss the protections available against this abuse: self-protection, which is generally unavailable to non-adjusting creditors, and the protections that are created through provisions of law which aim to prevent abusive behaviour, correct incentives that lead to the abuse, or redress the consequences of the abusive behaviour. It is on the basis of this background section – necessarily detailed, since it provides the theoretical and principled basis for the research – that the dissertation's research questions, and associated scope and methodology, are developed and discussed in the remainder of this chapter.

1.1.1 Categories of creditors

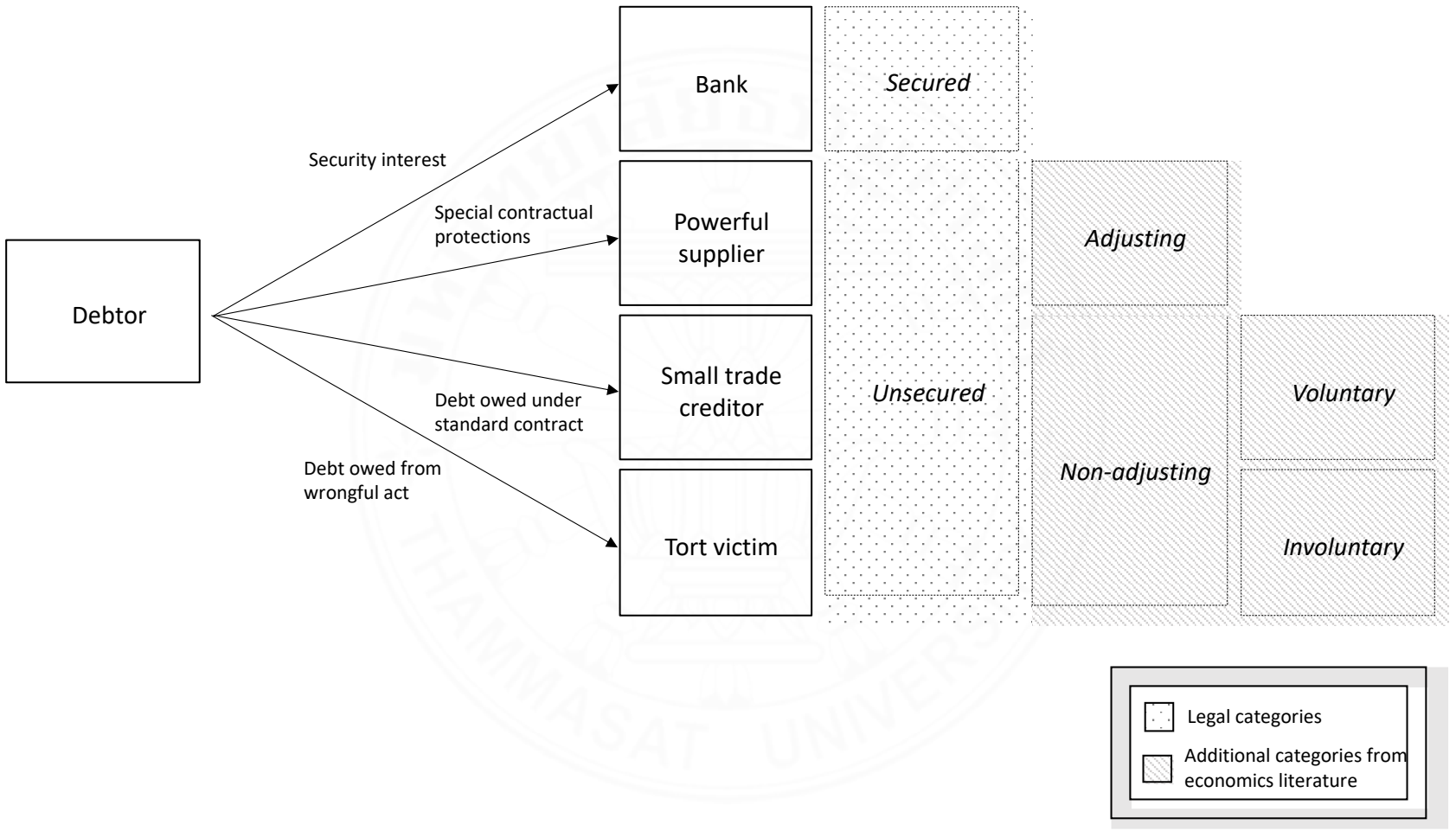
Bankruptcy law and doctrine recognises a distinction between secured and unsecured creditors. This, as discussed below, is of fundamental importance as it determines the order of priority in which they recover from an insolvent debtor. However, the category of unsecured creditors may itself be conceptually divided into adjusting and non-adjusting creditors, terms which are not recognised by bankruptcy law or doctrine.[1] An "**adjusting creditor**" is able to negotiate the terms of their credit. For example, a creditor with significant negotiating power may be able to secure contractual protections, or guarantees from the debtor's parent company, shareholders, or bank, to protect herself against the risk of the debtor company failing to pay. A "**non-adjusting creditor**" is not able to negotiate for such protection.

Non-adjusting creditors can be further divided into "**voluntary**" and "**involuntary**" non-adjusting creditors, based on whether or not they agreed to become creditors at all. In practice, a small trade supplier will be forced to accept a powerful customer's standard terms and conditions which will not provide any

[1] Lucian Arye Bebchuk and Jesse M Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' (1995) 105 Yale Law Journal 857, 880–891.

contractual protections against the risk of the customer failing to pay. The trade supplier merely has the choice either to refuse to enter into the supply arrangement or to proceed and accept the risks. However, even this choice is not available to involuntary non-adjusting creditors, who become creditors of a company without making the decision to do so. A classic example is a tort victim, to whom a company owes a debt as a result of committing a tortious act. Other examples include customers in respect of goods or services paid for in advance, employees in respect of wages owed, and the state in respect of taxes owed by the debtor. The relationship between the different conceptual categories is shown on **Error! Reference source not found.** below, which includes an example of a creditor in each category for illustration.

Figure 1 – Categories of Creditors



1.1.2 Non-adjusting creditors and insolvency

Non-adjusting creditors are highly unlikely to make a complete recovery of the debts owed to them by a private limited company through an insolvency process; indeed, in many cases they may not make any recovery at all. Two major reasons for this are the ranking of creditors in the order of recoveries in insolvency and the value-destructive nature of insolvency processes.

When a business enters insolvent liquidation, the Bankruptcy Act BE 2483 (the "BA") specifies the order in which the assets of an insolvent company are to be distributed among the different classes of creditors.[2] Secured creditors receive the highest priority in terms of their recovery, since assets against which security is enforced do not form part of the estate of the insolvent company to the extent that they are required to meet the secured creditors' claims.[3] Secured creditors therefore usually do not need to share the proceeds of enforcing security with other creditors; they participate in pursuing claims against the debtor's other assets only to the extent that there is a shortfall in the debt owed beyond the amount recovered from enforcing their security.[4]

Unsecured creditors – including non-adjusting creditors – face significant obstacles in making recovery of debts owed to them in insolvency. Aside from the proceeds of secured properties, which go to satisfy the claims of secured creditors, the remaining assets of the insolvent company must first[5] be used to pay the insolvency office holder's expenses, a fee for the collection of property calculated at 3% of the company's net assets,[6] fees incurred by the plaintiff creditor and its lawyers, taxes and duties for the six-month period before the bankruptcy order, and sums to cover remuneration for services performed by employees.[7] Only then will any remaining proceeds of the insolvent company's estate be distributed rateably among

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[2] Section 130 BA.
[3] Section 95 BA.
[4] Section 96(2) BA.
[5] The order of payments is specified in Section 130 BA.
[6] Section 179(4) BA.
[7] The remuneration includes employees' basic pay, overtime, holiday, severance pay and other money for services for the preceding 4 months, subject to a cap of 100,000 baht: Section 130 BA, s.257 CCC and labour protection law, see Auen Kunkeaw, *Bankruptcy Law* (13th edn, Krungsiam Publishing Co, Ltd 2016) 296 (Thai language).

other unsecured creditors.[8] Ultimately, unsecured creditors, other than the state and employees, perhaps, who receive a measure of priority, frequently face a slim prospect of making any significant recovery of debts in insolvent liquidations which involve secured creditors.

Furthermore, insolvency processes are often lengthy and carry high costs. The World Bank's 'Doing Business 2020' report estimates, in relation to an insolvent small private limited company, a recovery rate (cents on the dollar recovered by secured creditors) in Thailand of 70.1% of debt after 1.5 years, using a business reorganisation procedure incurring costs of 18% of the business' estate.[9] In other words, the costs of business reorganisation of a small company are estimated to absorb nearly a fifth of the company's remaining assets and the process is estimated to take one and a half years. Ultimately, the secured creditors in the case study in Thailand did not completely recover their debt, meaning that there was insufficient remaining value to make any distribution to unsecured creditors at all. Indeed, the fact that assets will not be sufficient to fully pay off all creditors is inherent in formal insolvency processes, since the company's debts must exceed its assets in order to enter the process.[10]

Between 2017 and 2019, 2,858 juristic persons entered bankruptcy proceedings in Thailand, with total debts in excess of THB 370 billion.[11] Private companies are the most common form of registered juristic person in Thailand, carrying, in aggregate, the lion's share of money invested in businesses in the economy. As of the end of June 2022, there are 1,755,751 juristic persons registered in Thailand, of which 842,632 are conducting business with a total registered capital of THB 20.22 trillion. Of these, 638,470 are private limited companies with a total capital of THB 14.43 trillion. Public limited companies, by contrast, number 1,348

[8] Section 130(5) BA.
[9] The results are based on a questionnaire for responses of local insolvency practitioners to a fictional scenario of a small private limited company in financial difficulty. World Bank, Doing Business 2020: Thailand <https://www.doingbusiness.org/content/dam/doingBusiness/country/t/thailand/THA.pdf> accessed 11 November 2022.
[10] Sections 9 and 90/3 BA.
[11] Statistics obtained from the Legal Execution Department contained at Annex 1. Figures for the years covered by the COVID-19 pandemic are not included here on the basis that this crisis constituted an exceptional and unrepresentative period.

with a combined capital of THB 5.31 trillion.[12] At the time of writing, the global economy has undergone a severe downturn due to the Covid-19 pandemic, with a slow recovery. Thailand's economy contracted by 6.2% in 2020 with GDP growth recovering only to 1.6% in 2021.[13] As a result of this crisis, combined with factors such as and government policies encouraging small and medium-sized enterprises to incorporate private limited companies,[14] there will most likely be an increase in private limited companies entering into insolvency processes; as argued above, the losses incurred will fall first and foremost on unsecured creditors, who typically make no recovery from a company's insolvent liquidation.

1.1.3 Agency problems

Structural features of the limited company result in incentives for managers and shareholders to benefit themselves at the expense of creditors, particularly in the case of smaller private limited companies facing financial difficulties.

Two fundamental features of the limited company are the separate personality of the company and the limited liability of its shareholders.[15] Separate legal personality acknowledges the existence of the company as a legal person separate from its shareholders, capable of owning assets in its own name and making them available for attachment by creditors.[16] Under the doctrine of limited liability, the shareholders are not personally liable to contribute assets to the company's creditors in insolvent liquidation beyond the level which they previously agreed to

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[12] Statistics dated 30 June 2022: <https://www.dbd.go.th/download/document_file/Statisic/2565/H26/H26_202206.pdf> accessed 11 November 2022.

[13] World Bank, National Accounts Data <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2021&locations=TH&start=2016> accessed 11 November 2022

[14] See the Office of Small and Medium Enterprise Promotion's 2017-2021 SME Promotion Plan <https://www.sme.go.th/th/download.php?modulekey=12> accessed 11 November 2022 and factors such as the funding approval requirements of the Small and Medium Enterprise Development Bank encourage incorporation of businesses as limited companies: e.g. <https://wdev.smebank.co.th/page-article-funding/> accessed 11 November 2022.

[15] Paul Davies, *Introduction to Company Law* (2nd edn, Oxford University Press 2010) 34; Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017) 5; Christopher Bruner, 'The Corporation's Intrinsic Attributes' in Barnali Choudhury and Martin Petrin (eds), *Understanding the Company: Corporate Governance and Theory* (Cambridge University Press 2017).

[16] Kraakman and others (n 15) 6; Ben Pettet, *Company Law* (Pearson Education 2005) 23.

invest in the company; for example, the full subscription value of company's shares.[17] These features work together to create a concept which has been termed "asset partitioning:"[18] the assets of the company are available only for the creditors of the company, and the personal assets of the shareholders are available only for the creditors of the shareholders.[19]

Asset partitioning is associated with a number of advantages for the functioning of the economic environment that are well-documented in academic literature.[20] However, it also creates the problem of moral hazard.[21] Shareholders, who derive their rewards from a company's profits, reap the benefits of a risky business activity which succeeds. However, because their personal assets are protected, they do not bear all of the costs of failure. This creates incentives for shareholders to encourage companies to take excessive risks. Creditors, by contrast, must rely on managers, under the influence of shareholders, to run the business in such a way that their debt will be repaid. This gives rise to "agency problems:"[22] in particular, three broad categories of opportunistic behaviour by shareholders and managers to benefit themselves at the expense of creditors.

Firstly, the shareholders may, by a variety of mechanisms,[23] induce managers to transfer assets to them from the company.[24] This is sometimes referred to

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[17] P Davies and S Worthington, *Gower's Principles of Modern Company Law* (10th edn, Sweet & Maxwell 2016) 33.

[18] See Kraakman and others (n 15) 9; Henry Hansmann, Reinier Kraakman and Richard Squire, 'Law and the Rise of the Firm' (2006) 119 Harvard Law Review 1333.

[19] These concepts are termed, respectively, "entity shielding" and "asset shielding" - see Kraakman and others (n 15); Henry Hansmann and Reinier Kraakman, 'The Essential Role of Organizational Law' (2000) 110 Yale Law Journal 387, 411–13.

[20] See e.g. Ben Pettet, 'Limited Liability–A Principle for the 21st Century?' (1995) 48 Current Legal Problems 125; Frank H Easterbrook and Daniel R Fischel, 'Limited Liability and the Corporation' (1985) 52 The University of Chicago Law Review 89; Paul Halpern, Michael Trebilcock and Stuart Turnbull, 'An Economic Analysis of Limited Liability in Corporation Law' (1980) 30 The University of Toronto Law Journal 117.

[21] Jonathan M Landers, 'A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy' (1974) 42 University of Chicago Law Review 589, 619–20; Christopher D Stone, 'The Place of Enterprise Liability in the Control of Corporate Conduct' (1980) 90 Yale Law Journal 1, 65–76.

[22] Kraakman and others (n 15) 29.

[23] See Peter O Mülbert, 'A Synthetic View of Different Concepts of Creditor Protection, or: A High-Level Framework for Corporate Creditor Protection' (2006) 7 European Business Organization Law Review 357.

[24] Robert Charles Clark, 'The Duties of the Corporate Debtor to Its Creditors' (1977) 90 Harvard Law Review 505, 506–17.

as "asset dilution"[25] and harms creditors by reducing the assets which are available for them to claim against, while increasing shareholders' personal wealth or the wealth of a party closely connected to a shareholder.[26]

Secondly, creditors may be harmed where the company increases the risks involved in its business, particularly through what has been termed "asset substitution."[27] Here, the company may sell low risk assets and use the proceeds to purchase assets for use in a high-risk business. In theory,[28] shareholders will benefit from increased profits generated by the high-risk business; creditors will be prejudiced, since they made the decision to extend credit based on the low-risk nature of the company's business before the asset substitution.

Thirdly, shareholders may benefit at the expense of a company's creditors from an increase in the company's overall borrowing, or "debt dilution."[29] The harm to the original creditors is created by the presence of new creditors. If a business takes on additional borrowing and then fails, new creditors will compete with old creditors in claims against the company's assets. This reduces the expected recoveries of the old creditors: the company's remaining assets must be shared among more parties. Conversely, shareholders derive a benefit. Had the old creditors known that there would be new creditors at the time of extending credit, they would have altered the terms of lending to take into account the lower expected recoveries on insolvency due to competition with new creditors.[30] These three agency problems are shown in Figure 2 below.

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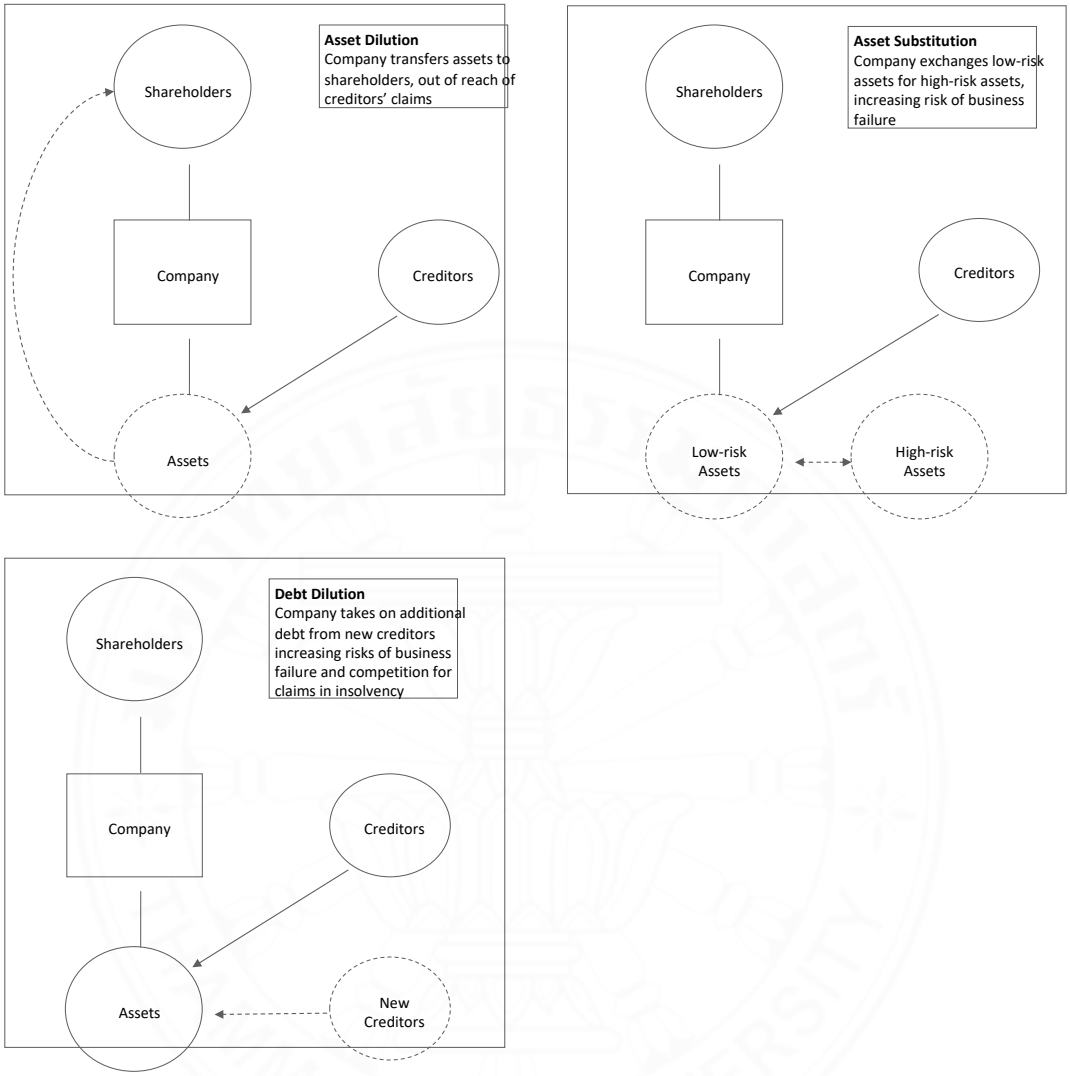
[25] This is also referred to in law and economics literature as "self-dealing" or "tunneling". See Simon Johnson and others, 'Tunneling' (2000) 90 American Economic Review 22.
[26] Kraakman and others (n 15) 111.
[27] Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305; Bezalel Gavish and Avner Kalay, 'On the Asset Substitution Problem' [1983] Journal of Financial and Quantitative Analysis 21.
[28] Empirical evidence surrounding the significance of asset substitution is mixed. See Erik P Gilje, 'Do Firms Engage in Risk-Shifting? Empirical Evidence' (2016) 29 The Review of Financial Studies 2925; Pablo Hernández-Lagos, Paul Povel and Giorgo Sertsios, 'An Experimental Analysis of Risk-Shifting Behavior' (2016) 6 Review of Corporate Finance Studies 68.
[29] Alan Schwartz, 'A Theory of Loan Priorities' (1989) 18 The Journal of Legal Studies 209.
[30] Kraakman and others (n 15) 112.

Figure 2 – Asset Dilution, Asset Substitution, and Debt Dilution



Asset substitution and debt dilution each cover relatively specific actions: the former concerns the change of a business' risk profile, involving the sale of assets for use in a low-risk business in exchange for assets for use in a high-risk business, and the latter concerns an increase in borrowing. Conversely, asset dilution covers any action by which the net assets of a company are reduced and therefore not available to satisfy creditors' claims. Examples of such actions include the following, presented in Table 1.

Table 1 – Actions Resulting in Asset Dilution

Action resulting in asset dilution	**Description**
1. Capital reduction	Reducing the company's capital, e.g. by way of dividend payments, share repurchases, forgiving requirements on shareholders to pay up their subscriptions, etc. The net assets of the company are reduced, prejudicing creditors' claims.
2. Undercapitalisation	A failure of shareholders to provide a sufficient amount of capital to a company to operate its business activities. This protects the personal assets of shareholders, while allowing a bare minimum of funds to be available to satisfy creditors' claims.
3. Mixing assets/alter ego	A dominant shareholder treating assets as her personal property and the company as her *alter ego*. Assets of the company are mixed with the personal assets of the shareholder. Any losses are treated as falling to the company, and any profits as falling to the shareholder personally.
4. Managers taking inappropriate risks acting inappropriately in financial difficulties	In financial difficulties, funds representing the shareholders' equity will have been eroded. Shareholders have nothing further to lose and pressure managers to take large risks in the hope of returning to profitability. This typically leads to a net loss of the company's assets compared to the position if such risks had not been taken.
5. Undervalue transactions	Entering into transactions with third parties (including shareholders) at an undervalue resulting in a net transfer of assets away from the company. The net assets of the company are reduced, prejudicing creditors' claims.
6. Preferences	Preferential transactions in which some creditors (who may also be shareholders) are paid in preference to others. Although the total net value of the company's assets is unaffected, these transactions result in the reduction of the assets against which the other creditors may claim.

The likelihood of firms engaging in these activities depends on the extent to which managers will accept the risk of doing so, and the extent to which shareholders have control over the necessary decisions that the firm must take.[31] If managers do not own significant equity stakes and are not personally accountable to a controlling shareholder, they are less likely to engage in such behaviour – if the

[31] ibid.

company becomes insolvent, the consequent reputational harm and potential legal liability could outweigh any personal benefit they receive. However, where there is an overlap or close connection between managers and shareholders, typically the case in small or closely held companies,[32] managers may have more incentives to engage in such behaviour.[33] Therefore this agency problem, and the risks of asset dilution, asset substitution and debt dilution, is considered to be particularly intense in closely held firms.[34] Notably, these incentives also become more acute when a company is in financial difficulty; with only a small chance of returning to profitability, shareholders and managers become tempted to extract all the value that they can from the assets that are left, which would otherwise only go to satisfy creditors' claims, or to increase business risks and essentially gamble their way back to profitability.

1.1.4 Creditor self-protection and protections offered by the law

Some creditors may effectively protect themselves against the abusive behaviour described above through taking security and contractual protections. However, these protections are not available to non-adjusting creditors, who cannot vary the terms on which they extend credit. Instead, they must rely on protections offered by the law which do not require negotiation with, or the agreement of, the debtor company.

1.1.4.1 Legal mechanisms protecting creditors

Thai law provides a host of different mechanisms, including by way of civil law and criminal law, which creditors may use – or the deterrent effect of which may operate – to address asset dilution, asset substitution and debt dilution. These mechanisms may be seen to target different groups of those who are connected with the company to prevent or reverse the effects of the various activities. Table 2 below offers a categorisation of the different mechanisms which address different forms of asset dilution, asset substitution and debt dilution discussed in 1.1.3 above. There are five broad conceptual categories of creditor protection mechanisms, divided

[32] Closely held, or close, companies have a small number of shareholders who do not trade their shares in the company: typically small family businesses. John H Farrar and others, *Farrar's Company Law* (Butterworths 1998) 302.
[33] Davies (n 15) 78.
[34] Rizwaan Jameel Mokal, *Corporate Insolvency Law: Theory and Application* (Oxford University Press 2005) 289–92.

along the lines of different groups who are connected to the debtor company: creditor self-protection, legal capital rules, challenging transactions, directors' duties and obligations to preserve the interests of creditors, and shareholder liability.

1. Creditor self-protection. This category encompasses protections negotiated with a company debtor, and include proprietary protection through taking security over the debtor's assets, and contractual protection, either by way of guarantees from shareholders or third parties, or enforceable promises by the debtor company to take, or refrain from taking, actions which might prejudice the creditor. These are not available to non-adjusting creditors.

2. Legal capital rules. This category brings together rules which govern the capital structure of the debtor company itself. These rules aim to control the way in which capital is contributed to a company, the way it is maintained and invested in the company's business assets and the ways in which it may be passed to shareholders. They aim generally at preventing asset dilution through capital reductions. These rules are found primarily in the CCC, but supporting criminal provisions are also found in the Offences Act.

3. Challenging transactions. Into this category are placed rules which allow creditors, or insolvency office holders on their behalf, to challenge transactions between the debtor company and third parties which result in harm to creditors. This harm may be caused through undervalue transactions or repaying some creditors in preference to others, both of which can be seen as forms of asset dilution. These rules are found both in the CCC and in the BA. While there are also provisions allowing transactions to be challenged under the Money Laundering Control Act BE 2542 (1999), these are out of the scope of research as discussed in Section 1.3 below

Table 2 – Categorisation of Creditor Protection Mechanisms and Provisions

Category	Subcategories	Scope of Protection	Relevant Laws	Primary In-scope Provisions
Creditor self-protection	• Proprietary protection • Contractual protection (guarantees) • Contractual protection (negotiated terms)	All forms of asset dilution, asset substitution and debt dilution	• CCC (Book III, Title XI-XIII); BCA (Ch IV-VI) • CCC (Book III, Title XI) • CCC (Book II, Title I-II)	N/A
Legal capital rules	• Legal capital rules • Criminal offences regarding capital	Capital reductions	• CCC (Book III, Title XXII) • Offences Act (Ch I)	• 1105, 1114, 1119 para 2, 1120, 1143, 1201 para 3, 1202, 1224-6 CCC • 12, 19, 22, 48 Offences Act
Challenging transactions	• Challenging transactions occurring before formal insolvency • Challenging transactions under money laundering control legislation	• Undervalue transactions • Preferences	• CCC (Book II, Title I); BA (Ch IV, Part III) • MLCA (Ch I, VI)	237-240 CCC; 113-116 BA
Directors' duties and obligations to preserve creditors' interests	• Directors' duties • Criminal offences in relation to directors' duties	• Taking inappropriate risks • Acting inappropriately in financial difficulties • Asset substitution and debt dilution	• CCC (Book III, Title XXII) • Offences Act (Ch 1); BA (Ch VII); MLCA (Ch VII); BCA (Ch VIII)	• 1167-9 CCC • 40-1 Offences Act; 164, 166, 173 BA
Shareholder liability	• Piercing the corporate veil • Cases under consumer protection legislation	• Undercapitalisation • Mixing assets/alter ego	• CCC (s. 5) • CCPA (s. 44 para 1)	5 CCC; 44 para 1 CCPA

4. Directors' duties and obligations to protect creditors' interests. Into this category are placed rules which target company managers, to create incentives for them not to act in ways which bring harm to creditors. This category comprises both general directors' duties under the CCC as well as supporting criminal provisions in the Offences Act and the BA. Provisions in other identified legislation are out of scope as discussed in Section 1.3 below.

5. Shareholder liability. Into this category are placed legal mechanisms which make shareholders personally liable for claims of creditors which exceed the debtor company's assets. These comprise the judicially developed concept of 'piercing the corporate veil', based on Section 5 of the CCC, and Section 44 para 1 of the CCPA which places the judicially developed concept on a statutory footing for consumer cases. These mechanisms primarily address undercapitalisation in some circumstances and mixing assets/alter ego: forms of asset dilution.

1.1.4.2 Scope of protection

Although this categorisation reveals a variety of different protective legal mechanisms for creditors, some offer broader protections than others. This becomes evident when the operation of the different protection mechanisms is divided among the different conceptual categories of creditor discussed above. Table 3 below displays, for each protection mechanism shown in the furthest left column, the activity addressed by each and, in the furthest right column, the person who is protected.

As can be seen from Table 3 below, proprietary protection, benefiting secured creditors, addresses every identified activity involved in asset dilution, asset substitution and debt dilution. Security rights give the secured creditor control over the assets of the company; attempts to remove the value represented by the secured assets from the company will fail since, in practice, the secured creditor can prevent transfers of the secured assets. This control addresses all activities involved in asset dilution and asset substitution. Furthermore, debt dilution is not a concern for secured creditors: new creditors will not be able to claim against secured assets in priority to secured creditors.

Table 3 – Table of Creditor Protection Mechanisms

Protection mechanism	**Asset Dilution**							**Asset Substitution**	**Debt Dilution**	**Who is protected**
	Capital reductions	Under-capitalisation	Mixing assets/ alter ego	Taking inappropriate risks	Acting inappropriately in financial difficulties	Undervalue transactions	Preferences	Selling low risk assets and purchasing high risk assets	Taking on additional debt	
Proprietary protection	X	X	X	X	X	X	X	X	X	Secured creditors
Contract (guarantee)	X	X	X	X	X	X	X	X	X	Adjusting creditors
Contract (negotiated)	X	X	X	X	X	X	X	X	X	Adjusting creditors
Legal capital rules	X									All creditors
Criminal offences re: capital	X									All creditors
Challenging transactions						X	X			All creditors
Directors' duties				X	X			X	X	All creditors
Criminal offences re: directors				X	X			X	X	All creditors
Shareholder liability (veil piercing)		X	X							All creditors
Shareholder liability (CCPA)		X	X							Consumers

This reveals that the manner by which creditors may be protected against asset dilution, asset substitution and debt dilution varies starkly in relation to each type of creditor. Powerful secured and adjusting creditors may potentially avail themselves of proprietary and strong contractual protections which guard against every kind of abusive behaviour. As a result, protection offered through the law relating to legal capital, challenging transactions, directors' duties or shareholder liability may be entirely inconsequential. However, this is in direct contrast to the position of non-adjusting creditors, voluntary and involuntary: the legal mechanisms relating to legal capital, challenging transactions, directors' duties or shareholder liability, including the deterrent effect from criminal law provisions, are the only protections available against asset dilution, asset substitution and debt dilution.

1.2 Research Questions

Against this background, this dissertation aims to answer the following research questions:

1.2.1 Question 1: Are non-adjusting creditors of private limited companies sufficiently protected in Thailand?

In order to answer this question, it is necessary first to establish a yardstick by which the level of protection can be evaluated. Some businesses must inevitably fail, and therefore at least one of the different groups associated with the limited company must suffer harm as a consequence. Legal systems must make a trade-off between the protections offered to shareholders and managers by the doctrines of limited liability and separate personality, and the risks to creditors arising from the associated agency problems.

There have been attempts to establish a direct link between laws protecting creditors and economic development, in particular by a network of

academics which has come to be known as the law and finance movement.[35] The impact of these and following studies using similar methodology has been highly significant: in academic scholarship, they are among the most cited papers in economics and law.[36] However, the movement's methodology and conclusions have come under strong and sustained criticism especially from law academics.[37] In particular, serious doubts have been raised about the leximetrical methodology,[38] the equal weighting ascribed to different variables,[39] the limited number of variables,[40] the apparent US bias of the variables,[41] the accuracy of the coding,[42] the direction of causality,[43] and conflicts with the results of later studies using similar methodology.[44] As a result of this criticism, the conclusions of the initial studies of the law and finance movement should be treated with scepticism. Thus, it seems that there is no reliable consensus on a universal optimal level of creditor protection that any legal system should adopt to further its economic development. Instead, the question of what is considered a sufficient level of protection can be considered as a normative one, related to questions of the corporate objective and the field of study of corporate governance.

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[35] The law and finance movement began with two seminal articles in 1997 and 1998: Rafael La Porta and others, 'Legal Determinants of External Finance' (1997) 52 The Journal of Finance 1131; Rafael La Porta and others, 'Law and Finance' (1998) 106 Journal of Political Economy 1113.

[36] Mathias Siems and Simon Deakin, 'Comparative Law and Finance: Past, Present, and Future Research' (2010) Journal of Institutional and Theoretical Economics 120, 124.

[37] See Michael Graff, 'Legal Origin and Financial Development: New Evidence and Old Claims' (2012) 3 International Journal of Trade, Economics and Finance 164.

[38] Mathias M Siems, 'Numerical Comparative Law: Do We Need Statistical Evidence in Law in Order to Reduce Complexity' (2005) 13 Cardozo Journal of International and Comparative Law 521.

[39] Beth Ahlering and Simon Deakin, 'Labor Regulation, Corporate Governance, and Legal Origin: A Case of Institutional Complementarity?' (2007) 41 Law and Society Review 865.

[40] Priya P Lele and Mathias M Siems, 'Shareholder Protection: A Leximetric Approach' (2007) 7 Journal of Corporate Law Studies 17; Katharina Pistor, 'Rethinking the Law and Finance Paradigm' [2009] Brigham Young University Law Review 1647.

[41] John Armour and others, 'How Do Legal Rules Evolve? Evidence from a Crosscountry Comparison of Shareholder, Creditor, and Worker Protection' (2009) 57 American Journal of Comparative Law 579; Udo C Braendle, 'Shareholder Protection in the USA and Germany-Law and Finance Revisited' (2006) 7 German Law Journal 257.

[42] Armour and others (n 41) 585; Sofie Cools, 'The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers' (2005) 30 Delaware Journal of Corporate Law 697.

[43] Armour and others (n 41) 586.

[44] Armour and others (n 41); John Armour and others, 'Law and Financial Development: What We Are Learning from Time-Series Evidence' (2009) Brigham Young University Law Review 1435.

1.2.1.1 Evaluation by enlightened shareholder value (ESV)

While there is a wide diversity of theoretical models of corporate governance which may be identified in academic literature,[45] conventionally they are categorised within one of two opposing perspectives: the shareholder perspective and the stakeholder perspective.[46] Models conforming to the shareholder perspective are based on the assumption that the purpose of the company is to maximise shareholders' wealth; those conforming to the stakeholder perspective assume that companies must promote the welfare of a wider range of groups who are affected by them.[47] More recently, a further influential theoretical approach has been developed as an alternative, enlightened shareholder value ("ESV") which adopts the structure of instrumental stakeholder theories but adopts the shareholder value maximisation approach as a method by which the different stakeholders' interests may be ordered.[48]

The traditional view of the model of corporate governance adopted in Thailand has been shareholder-centric.[49] However, this has arguably changed in recent decades, at least in relation to listed public limited companies, as evidenced by the SEC's Principles of Good Corporate Governance, the latest version of which is the Corporate Governance Code 2017 ("CG2017").[50] The CG2017, in its statement of its objectives, emphasises the concept of a company's long-term sustainable value creation. The value created includes not only "good for the company, but also for its shareholders, stakeholders, the capital market and the

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[45] Major reviews of corporate governance literature classifying the different theories include Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) 52 The Journal of Finance 737; Shann Turnbull, 'Corporate Governance: Its Scope, Concerns and Theories' (1997) 5 Corporate Governance: An International Review 180; Kevin Keasey, Steve Thompson and Mike Wright, 'The Corporate Governance Problem: Competing Diagnoses and Solutions' (1997) Corporate Governance: Economic and Financial Issues 1.

[46] See Steve Letza, Xiuping Sun and James Kirkbride, 'Shareholding versus Stakeholding: A Critical Review of Corporate Governance' (2004) 12 Corporate Governance: An International Review 242.

[47] See e.g. Mary O'Sullivan, Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany (Oxford University Press 2001).

[48] Michael C Jensen, 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function' (2001) 14 Journal of Applied Corporate Finance 8.

[49] Saravuth Pitiyasak, 'Thai Company Laws and Good Governance Practices of Unlisted Companies' in Sakulrat Montreevat (ed), *Corporate Governance in Thailand* (Institute of Southeast Asian Studies 2006) 93.

[50] 'Corporate Governance Code 2017' <https://www.sec.or.th/cgthailand/en/pages/cgcode/cgcodeintroduction.aspx> accessed 11 November 2022.

society at large,"[51] and the CG2017 states that shareholders and the business community at large expect a company to have a "balanced relationship with stakeholders"[52] in order to be able to compete and achieve long-term sustainability. Creditors are mentioned specifically in the guidelines to Principle 7.3 which call for enhanced monitoring by the board in the event of financial difficulties and ensuring that the company has sound financial mitigation plans that "consider stakeholder rights including creditor rights."[53] The board should ensure that any actions to improve the company's financial position are reasonable and made for proper purpose.[54]

This points clearly to the adoption in the CG2017 of an ESV approach, viewing long-term value creation as its goal and including consideration of other interests beyond those merely of shareholders, extending to employees, customers, the wider community and the environment. That it remains an ESV approach, rather than a full recognition of a stakeholder view, can be seen from references, such as that in Principle 5.1,[55] to the fact that the board should promote innovation that creates value for the company and its shareholders, with the benefits for customers and other stakeholders appearing only "together with" this value creation. Benefits for customers and other stakeholders are not presented as the primary objective.

The CG2017 is not mandatory even for the listed public limited companies for which it is prescribed: it operates on an "apply or explain" basis, where firms must apply the principles or explain in their annual report the reasons why they have not.[56] Thus it is not intended to apply to private limited companies, and it is not used as a legal source for the analysis performed in this dissertation. Rather, the fact that the CG2017 has adopted an ESV approach provides support for using this as the normative basis for analysing the protection of non-

[51] ibid.
[52] ibid.
[53] ibid 7.3.2.
[54] ibid 7.3.3.
[55] "The board should prioritise and promote innovation that creates value for the company and its shareholders together with benefits for its customers, other stakeholders, society and the environment, in support of sustainable growth for the company" ibid 5.1.
[56] ibid 3.2.

adjusting creditors of private limited companies in Thailand. Arguments supporting this are as follows:

Firstly, private limited companies comprise vastly the largest number of firms established for business in Thailand and carry the largest share of invested capital of any juristic business form.[57] The National Corporate Governance Committee, chaired by the Prime Minister, has signalled with the CG2017 that an ESV approach is best practice for the largest companies because of their significant impact on society and the business environment. Given that private limited companies likely have, it follows, in aggregate, a greater impact on society and the business environment than listed companies due to their larger numbers and amount of invested capital, it follows that they should also be encouraged to adopt an ESV approach.

Secondly, to adopt a position where listed companies have a different concept of the corporate objective to private limited companies creates a fundamental distinction between the two business forms. One result of this might be to create a factor discouraging private limited companies from changing their corporate form and listing on a stock exchange, since to do so would require a change in their corporate objective. Another potential result of this may be to discourage some creditors from dealing with private limited companies, or to deal with them on less favourable terms than public limited companies. Indeed, although the CG2017 is aimed only to constitute best practice for listed public limited companies, from an interview conducted with an expert from the SEC as part of the research for this dissertation, it was seen as uncontroversial that the general values represented in the CG2017, particularly in relation to stakeholders, could be applied, as best practice, to private limited companies.[58]

Thirdly, from the point of view of an involuntary non-adjusting creditor, to have a different legal approach to her protection in the case of a listed public company from a private limited company is difficult to support. Since involuntary creditors do not choose to extend credit to the debtor, whether they become a creditor of a private limited company or a listed public company is a matter

[57] See n 12.
[58] A summary of the interview is attached at Appendix 3.

of chance. Furthermore, even from the point of view of voluntary non-adjusting creditors, large private limited companies operate in the same sectors, and may be of the same size and have a similar organisational structure to public listed companies. Most importantly, both public limited companies and private limited companies have the features of limited liability and separate personality resulting in the agency problems discussed above. For the policy of the law to be that each organisational form should have a different objective as regards the consideration of the interests of creditors seems to lack a normative or economic justification.

Fourthly, it may be argued that a consistent approach across both private limited companies and listed public companies may assist with the implementation of the CG2017, and its ESV approach, by listed public companies. There is empirical research which indicates that a factor affecting compliance with corporate governance codes on a national level is the overall institutional environment including the legal norms that apply: where principles in corporate governance codes are controversial, in the sense that they conflict with the norms present in the legal system generally, such principles are less often followed.[59] Therefore, a consistent approach across the business environment generally, including that applicable to private limited companies, would improve the likely successful implementation of the CG2017 by listed public limited companies.

1.2.1.2 Protection of creditors under the ESV approach

A leading proponent of the ESV approach, Michael Jensen,[60] points out that although stakeholder centric theories argue that managers of a company should take into account stakeholder interests, none of the theories clearly identify how the different groups and interests should be traded-off against one another. This would result in wide discretion for managers, and effectively no

[59] See e.g. Christian Andres and Erik Theissen, 'Setting a Fox to Keep the Geese—Does the Comply-or-Explain Principle Work?' (2008) 14 Journal of Corporate Finance 289; Amon Chizema, 'Institutions and Voluntary Compliance: The Disclosure of Individual Executive Pay in Germany' (2008) 16 Corporate Governance: An International Review 359; Nasha Ananchotikul, Roy Kouwenberg and Visit Phunnarungsi, 'Do Firms Decouple Corporate Governance Policy and Practice?' (2010) 16 European Financial Management 712.
[60] Jensen (n 48).

accountability for their actions.[61] Jensen therefore advocates adopting the concept of maximisation of long-term shareholder value as the mechanism by which a decision on the trade-off may be made.

The justification for selecting shareholders as the group whose interests should prevail in a conflict is based on their position as the "residual claimants" to the firm's assets: the group entitled to whatever is left once payments with higher priority, such as creditors' claims, have been met.[62] This status is the primary justification for pursuing their interests for several reasons. First, since shareholders benefit from a company's profitability by receiving dividends or capital growth in the value of their shares, but will potentially lose all of their investment if the company performs poorly, they have the most at stake in the outcome of the company's business.[63] This gives them an interest in all decisions taken by directors,[64] making them the most appropriate group to decide on company policy.[65] From the creditors' point of view, in essence, provided that shareholders' only interest is in the surplus that a company generates – i.e. the firm's income which is left after meeting the creditors' claims for repayment – creditors are theoretically safe leaving the monitoring and control of a company's managers in the hands of shareholders. The shareholders have the rational goal of maximising their profit. Maximum profit means increased surplus. Increased surplus means that creditors will all have their claims met.[66]

However, this logic rests on several assumptions. First, shareholders must genuinely be the residual claimants. If shareholders' claims are paid in priority to creditors' claims, the fundamental justification for shareholder centric theories suffers. Second, shareholders must still have some possibility of

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[61] ibid 301.
[62] This is aligned to justifications based on Agency Theory of which Jensen was a leading proponent Jensen and Meckling (n 27). Agency Theory builds on famous insights of Ronald Coase: see Ronald H Coase, 'The Nature of the Firm' (1937) 4 Economica 386.
[63] Jonathan R Macey, 'Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective' (1998) 84 Cornell Law Review 1266, 1267.
[64] Jonathan R Macey and Geoffrey P Miller, 'Corporate Stakeholders: A Contractual Perspective' (1993) 43 University of Toronto Law Review 401, 408.
[65] Frank H Easterbrook and Daniel R Fischel, 'Voting in Corporate Law' (1983) 26 The Journal of Law and Economics 395, 403.
[66] See Paul Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' (2006) 7 European Business Organization Law Review 301.

recovering some value from the company in the future, and the amount they recover must depend on the performance of the firm and therefore the decisions of managers. Otherwise, shareholders have no incentive to monitor and pressure managers to maximise the firm's value. In a situation where the company has performed poorly so that its liabilities are greater than its assets and where there is little or no prospect of it returning to profitability soon, this presents a problem for the theory. Law therefore has a legitimate role in addressing these problems, which may serve as the basis for evaluation of the legal regime in relation to the ESV model.

1. First, legal strategies may be implemented to **ensure that shareholders maintain their status as residual claimants only**: this supports preventing asset dilution.

2. Second, the law may justifiably address a situation where there is little prospect of a firm returning to profitability. In such circumstances, shareholders effectively are no longer residual claimants since they have little prospects of recovering any value. Where this is the case, the creditors become the residual claimants: the performance of the firm will affect the amount that they will recover. This conceptually justifies, for example, rules of bankruptcy law which put creditors in effective control of a company or which otherwise **shift the objectives of the company to operating in creditors' interests where they become the residual claimants**.[67]

3. Furthermore, although the classic shareholder-centric view would not generally support restrictions on managers engaging in asset substitution and debt dilution, this is not the case under ESV. Under ESV, a conflict between different interests is resolved by considering what brings most value to shareholders in the long term. Asset substitution and debt dilution enhance returns for the shareholders in the short term, while prejudicing the stability of the company in the long term and the prospect of repayment of creditors. Therefore, a legal environment **which restricts the ability of companies to engage in asset substitution and debt**

[67] However, note that commentators disagree over whether a shift in the objectives of the company should occur at factual insolvency or only when the company enters formal insolvency proceedings. See e.g. Henry TC Hu and Jay Lawrence Westbrook, 'Abolition of the Corporate Duty to Creditors' (2007) 107 Columbia Law Review 1321.

dilution to benefit shareholders in the short term is normatively justified under ESV.

These principles of creditor protection under an ESV approach may therefore be used to evaluate the approach of Thai law to protecting non-adjusting creditors of private limited companies.

1.2.2 Question 2: How has the law relating to the protection of non-adjusting creditors of private limited companies in Thailand developed?

This dissertation does not solely aim to investigate and evaluate the current protections for non-adjusting creditors in Thailand; rather, it also aims to make practical recommendations for improvement based on its evaluation. The ESV model of corporate governance provides a normative and theoretical basis for the protection of the interests of company creditors, but it does not provide a blueprint for how such protection may be best achieved.

Many of the legal rules relating to the protection of non-adjusting creditors of private companies in Thailand have been in place for almost a century. On one hand, this raises the question of whether the law is still appropriate for today's business environment; on the other hand, however, this fact also advocates that reform should be recommended with care and values evident in the system and its general approach should be respected and not replaced without good reason. It is intended that recommendations should be nuanced and made with a thorough understanding of the manner in which the legal environment has developed and operates. Therefore, this dissertation must answer the second research question of how the law relating to the protection of non-adjusting creditors of private limited companies in Thailand has developed.

In order to answer this question in a way that may inform recommendations for improvement, this dissertation will combine a historical investigation approach with a functional comparative exercise. Functionalist comparative methodology tends to start at the level of the problem addressed by legal rules in one society, and then compare the approach adopted by a comparator society

to the same problem.[68] This has the key advantage of escaping structures of doctrine or legal concepts present in the comparatist's 'home' legal system, and allows for the fact that some systems may address the problem through non-legal institutions.[69] Major criticisms of functionalism include that the claimed objectivity or neutrality of focusing on the problem is false, since problems may be seen differently in different societies;[70] that the standard presumption of similarity[71] between different legal systems in terms of their solutions is inappropriate;[72] and that it does not produce an understanding of the internal structure of a legal system or how it came to be.[73] The methodology adopted here addresses each of these criticisms.

First, regarding the fact that problems may be seen differently in different societies, the general problem addressed here is the protection of non-adjusting creditors in the face of agency problems arising from the concepts of limited liability and separate personality. As such, the same problem will theoretically be present in any legal system in which the corporate form has these features, which is the case for the systems selected for comparison here. Although it may be queried whether the problem is equally serious in each system, this is merely a question about the extent of the problem; the basic nature of the problem is the same. Second, regarding the presumption of similarity, this dissertation adopts no presumption in comparing the approaches of the different systems; indeed, differences will be just as important as similarities for answering the research question. Finally, regarding understanding the internal structure of the system and how it came to be, this is at the heart of answering the second research question of how the Thai law relating to creditor protection has developed. Hence, the comparative exercise addressed here

[68] Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law* (Tony Weir tr, 3rd edn, Oxford University Press, 1998) 34; Ralf Michaels, 'The Functional Method of Comparative Law' in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (2nd edn, OUP Oxford 2019) 346.
[69] Peter De Cruz, *Comparative Law in a Changing World* (Cavendish London 1999) 223.
[70] Gunter Frankenberg, 'Critical Comparisons: Re-Thinking Comparative Law' (1985) 26 Harvard International Law Journal 411; Pierre Legrand, 'The Same and the Different' in Pierre Legrand and Roderick Munday (eds), *Comparative Legal Studies: Traditions and Transitions* (2003).
[71] Zweigert and others (n 67) 37.
[72] Marc Ancel, Utilité et méthodes du droit comparé, Eléments d'introduction générale à l'étude comparative des droits (Neuchâtel 1971) (French language); Legrand (n 70) 240.;
[73] Geoffrey Samuel, *An Introduction to Comparative Law Theory and Method* (Bloomsbury Publishing 2014) 164.

will also perform a historical investigation into how each of the systems has evolved its approach.

It is argued that many of the legal rules that protect non-adjusting creditors represent borrowings, or legal transplants, from systems that were particularly influential in the programme of widespread legal reform undertaken in Thailand in the late 19th and early 20th centuries, in particular England and Germany. As identified in Table 2 above, the core rules which are in the scope of analysis in this dissertation are found in the CCC, the BA, the Offences Act and the CCPA.

CCC: The influence of German law on the CCC, both directly and indirectly through its influence on Japanese law, is well documented.[74] However, English law was influential too, particularly on the CCC provisions of Book III in relation to private limited companies, which were heavily influenced by the earlier Partnership and Company Act of 1911,[75] itself influenced by English companies Acts[76] and the charters of charter companies operating in Siam in the late 19th and early 20th centuries.[77]

BA: The BA adopted an English law model,[78] as is made clear from notes made in connection with drafting the Act, which state that, although provisions of a number of other jurisdictions have shaped it, the law "should still be conducted in accordance with the manner of English bankruptcy law to the extent that

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[74] Department of Legal Studies in Society, Philosophy and History, *Transcript of Interview with Phraya Manavarajasevi (Plod Wichiar Na Songkla)* (Winyuchon Publication House 2014) 3–4, 28–30 (Thai language); Preedee Kasemsup, 'Reception of Law in Thailand-A Buddhist Society' in Masaj Chiba (ed), *Asian Indigenous Law: In Interaction with Received Law* (KPI 1986) 293; Munin Pongsapan, 'Reception of Foreign Private Law in Thailand in 1925: A Case Study of Specific Performance' (DPhil Thesis, University of Edinburgh 2013) 87.

[75] Act on Partnerships and Companies, Rattanakosin Era 130, Royal Gazette 17 September Rattanakosin Era 130, Vol 28, 206 (Thai language).

[76] Ministry of Justice Thailand and René Guyon, *L'Oeuvre de codification au Siam* (Imprimerie Nationale 1919) 20–21 (French language). The Bangkok Times, in reporting the promulgation of the new Act, noted that the "law as regards ordinary limited liability companies is largely on the lines of English company law": Bangkok Times, 22 September 1911.

[77] See for example correspondence between Georges Padoux and Prince Sithiporn dated 10 and 14 June 1910, in which Padoux requests copies of charters and articles of association of companies in Bangkok formed under Siamese law, which he supposes had been prepared by the General Adviser. The Prince's reply, enclosing several charters, recommends using the "Transport Motor Co" charter, which appears to have been adopted as the standard model for later charter companies. Archives of the Office of Juridical Council (AC 26/1) Roll 1/1, 261 and 267.

[78] In particular, the English Bankruptcy Act 1914: see Faculty of Law, Thammasat University (Prof. Sahaton Ratthanapaijitr et al), 'Research Report Concerning Project to Improve the Enforcement of Bankruptcy Cases in accordance with International Standards' (Thai language).

it was adapted in the Straits Settlement, Hong Kong and India for the most part, because it can be seen that the conditions of those three countries are most similar to Thailand."[79] However, relevant provisions bear influence of earlier Siamese Acts, in particular the Bankruptcy Acts of 1911 and 1908, which formed part of the same codification programme that produced the CCC and likewise represent a mix of influences.

Offences Act: The Offences Act has its origin in the Partnerships and Companies Act of 1911. At the time of the revision of Book III of the CCC in 1924, it was decided that offences and penalties from the Partnerships and Companies Act of 1911 would not be included in the CCC.[80] Instead, an amendment was made to the Penal Code in 1925[81] to incorporate the criminal provisions from the Partnerships and Companies Act of 1911, as somewhat modified by the drafting committee to tie in with the company law provisions of the CCC. In 1956, the part of the Penal Code including these offences was repealed and the provisions were incorporated in a separate Act – the Offences Act – on the basis that the Penal Code was being amended at that time and, according to the notes on the Offences Act, foreign laws do not include offences in relation to limited companies and other forms of juristic persons in their penal codes.[82] Many of the offences concerning limited companies are in much the same form as they appeared in the Partnerships and Companies Act of 1911, and therefore the Offences Act bears significant influence of early 20th century English law, while also shaped by the draftsmen of the CCC at the time of its incorporation into the Penal Code in 1925.

CCPA: By contrast, the CCPA was developed in response to specific social needs in Thailand, and without evidence of direct influence from other jurisdictions. Problems had been identified in relation to the barriers facing consumers bringing cases against businesses, in particular in relation to the burden of proof and

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[79] Book 328 Series 9 (Council of State), translation by the author. It should be noted that this record was not formally approved by the meeting of the law drafting committee, and therefore it can only be seen as a summary of the view of the member of staff who wrote the record of the view of the drafting committee in that meeting rather than as part of the official record.

[80] See Department of Legislative Redaction, Note concerning the Penalties in the matter of Partnerships and Companies and in the matter of Associations dated 2 March 1925, Archives of the Office of Juridical Council (AC 36/2) Roll 24, doc 2/4,131

[81] Act Supplementing the Criminal Law BE 2468, published 21 December 1925, Government Gazette Vol. 42 p.233.

[82] See note to the Offences Act.

problems concerning enforcing court judgments.[83] The CCPA gave new rights to consumers to bring cases and offered an accelerated process for pursuing such cases, including direct liability for shareholders to consumers in certain situations concerning businesses carried on otherwise than in good faith. As discussed in more detail in Chapter 5, this provision in the CCPA appears to be an attempt to put the judicially developed concept of piercing the corporate veil on a statutory footing for consumer cases. However, the concept of piercing the corporate veil itself in Thai law was apparently developed by the courts and academics with reference to similar concepts in other jurisdictions.

From this brief survey of the influences behind the drafting of the legislation relevant to the protection of non-adjusting creditors in Thailand, English and German law are prominent. However, since the relevant legislative provisions appear to be the product of a variety of sources, in order to address this research question it is necessary to conduct an investigation into the influences behind each core provision relating to creditor protection of non-adjusting creditors.

The method of investigation is as follows. In respect of the CCC, the "Book of Revised Drafts"[84] was consulted to identify the claimed sources of the provision. A linguistic comparison was then made between the English language final version of the CCC and English language translations of the sources identified in the Book of Revised Drafts; wherever possible, the English translation used was from the same edition of the text present in the library of the CCC's draftsmen. In the event that none of the stated sources in the Book of Revised Drafts were sufficiently similar in concept or language to the CCC provision, further enquiries were made using notes of the draftsmen and minutes of the meetings of the drafting committees, accessed via the National Archives and the archives of the Council of State. In relation to the BA, the Offences Act and the CCPA, reviews of each provision against the likely sources were made. The results of this research are presented in table form at Appendix 2, containing the provision, the wording of the provision, the list of foreign sources from

[83] See announcement concerning the need for the CCPA published in the Government Gazette, Vol 125, 38 gor, 51 on 25 February BE 2551; see also minutes of the meeting of the Council of State concerning the drafting of the Consumer Case Procedure Act no. 7/2550, 5 September BE 2550.
[84] A compilation of the English language drafts of the books of the CCC, which had passed through a revision committee stage, containing list of abbreviations for foreign statutes and legal sources.

the Book of Revised Drafts (for the CCC), the wording taken from the most similar source or sources, and a brief conclusion as to the likely source of each provision. The provisions in the table are ordered thematically, in accordance with the programme of this dissertation, as follows: legal capital (direct and indirect reductions); challenging transactions; directors' duties; and shareholder liability. The results of the comparison are discussed in each of the relevant chapters of this dissertation.

1.2.3 Question 3: Make nuanced recommendations for the improvement of Thai law relating to non-adjusting creditors

The objective of the comparative exercise used to answer the second research question is to identify the characteristics of the overall approach of Thai law to the protection of non-adjusting creditors. By performing a comparison with legal systems which fundamentally influenced Thai law, the manner in which the three systems have developed over time, and the evolution of different approaches within each of the systems, may be highlighted. Indeed, it is anticipated, consistent with some legal transplantation theories such as Teubner's theory of legal irritants,[85] that Thai law may represent an approach quite different to the legal systems from which the rules were transplanted. For example, the research may reveal that German law has developed an approach which tends to focus on protecting creditors through rules of legal capital, whereas English law focuses on enforcing standards of directors' conduct and recruiting third parties as monitors of undervalued transactions, while Thai law focuses on ethical conduct of directors and shareholders enforced with criminal penalties and state oversight. A conclusion such as this, if found, would be instrumental in recommending nuanced improvements for Thai law. Following through with this example, recommendations for Thai law should then focus on improving mechanisms regarding state oversight and ethical conduct of shareholders and directors, rather than, say, advocating for the adoption of a German judicially developed concept of disguised distributions linked to a legal capital regime. This is not to say that new concepts cannot be adopted into the Thai legal system; rather, an

[85] Gunther Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergencies' (1998) 61 The Modern Law Review 11.

evolutionary approach should generally be preferred to a revolutionary approach unless there are very good reasons to adopt the latter.

1.3. Scope

The scope of this dissertation is as follows:

1. This dissertation focuses on private limited companies. As discussed above, the agency problem resulting in the risk of harm to non-adjusting creditors is most acute in companies in which there is an overlap or close connection between shareholders and management. Therefore, this dissertation focuses on private limited companies, which typically have this characteristic, rather than public limited companies, which typically have a more dispersed ownership structure. However, the results of this dissertation may act as a useful starting point for similar research in relation to public limited companies.

2. This dissertation does not investigate contractual or proprietary protections for creditors. As discussed above, powerful and sophisticated creditors are often able to avail themselves of adequate protection through contractual restrictions and proprietary protections through security interests. Non-adjusting creditors cannot use such mechanisms but must instead rely on rules which are not subject to negotiation and agreement with the debtor company. In addition, the focus of this dissertation is abusive behaviour that may be carried out by the debtor following the conclusion of a contract with a non-adjusting creditor. Therefore, laws relating to unfair contract terms are not relevant since these will not protect non-adjusting creditors in these circumstances.

3. This dissertation focuses on companies before they enter formal insolvency proceedings. Once a company has been put into formal insolvency proceedings, a fundamentally different legal environment applies which is generally designed to protect creditors' interests, but which carries high costs and long delays. Furthermore, for a company to enter formal insolvency proceedings in Thailand, by nature its debts must already be greater than its assets. As discussed above, non-adjusting creditors are unlikely to make any recovery of their debt through a formal insolvency process. Therefore, this dissertation generally focuses on the period prior

to insolvency, and on the legal mechanisms to ensure that creditors' interests are appropriately protected earlier. Rules of insolvency law will nevertheless be applicable to this research: a number of them apply to decisions made by company managers and actions taken by the company before the company enters formal insolvency proceedings.

4. This dissertation generally excludes from its scope criminal laws relating to deception. The assumption adopted by this dissertation is that those involved in business generally do not carry out their activities with the deliberate intention to deceive and defraud their creditors. Therefore, for example, the provisions of the MLCA will fall outside of the scope, since relevant predicate offences focus on fraud or dishonest conduct in banks, finance businesses and companies operating under securities and exchange laws, all of which involve either deception or public limited companies or both. However, a number of criminal offences will nevertheless be relevant, where they do not relate to deception but nevertheless create incentives or a deterrent effect for managers or shareholders to take or refrain from taking certain activities which may cause harm to creditors.

1.4. Methodology

The method of conducting research is documentary research, conducted through studying, researching and analysing data based on applicable laws and regulations, court judgments, textbooks, commentaries, academic books, articles, reports and other publications including electronic media relating to the topic published in Thailand, England, Germany and elsewhere. It should be noted at the outset that the research methodology for this dissertation is generally restricted to publications in Thai and English languages, since the author does not read German. However, there is a wide array of in-depth English language scholarship regarding German company law. This dissertation also considers potential creditor protection mechanisms which are not currently part of the legal landscape, such as preventative strategies of better access to information which may assist voluntary creditors, for example. In addition, in order to ensure that recommendations for changes to law or practice are feasible, interviews have been conducted with relevant government

departments, specifically the DBD and the SEC, where recommendations require changes in their practice to be implemented, and feedback from such interviews has been incorporated into the recommendations.

1.5. Original Contribution

There are a number of journal articles and master's theses on different aspects of the protection of creditors of private limited companies in Thailand, which were consulted in the research for this dissertation. In addition, there are a number of major in-depth works, including textbooks and large-scale research reports, on company law and bankruptcy law generally. However, this is the first work to analyse the different legal provisions and mechanisms holistically in relation to the issue of the protection of non-adjusting creditors. This dissertation is also the first major work to evaluate the approach of Thai law to protecting non-adjusting creditors against an ESV model of the corporate objective and corporate governance which, as discussed, represents a relatively recent shift from the traditional shareholder-centric view. Finally, this dissertation represents a significant addition to Thai legal scholarship written in English, making the study of Thai law more accessible to English speaking scholars around the world.

1.6 Outline of Dissertation

This dissertation is comprised of seven chapters. This chapter has set out the background to the research, the research questions which will be answered, the scope and methodology of the investigation and the original contribution the research makes to scholarship. Chapters 2 to 5 then perform a comparative analysis of each of the four areas of creditor protection rules: legal capital rules (Chapter 2), challenging transactions (Chapter 3), directors' duties and obligations to preserve creditors' interests (Chapter 4) and shareholder liability (Chapter 5). Each chapter performs a functional comparative analysis in relation to each jurisdiction and compares how each jurisdiction has developed its approach over time. These chapters therefore address the first two research questions by highlighting the way in which Thai law

relating to the protection of non-adjusting creditors operates, to assist answering the first research question, and revealing the path of development of Thai law in comparison to English and German law, to assist answering the second research question. Each chapter also performs an analysis of Thai law's approach to creditor protection, using the ESV principles as discussed in Section 1.2.1.2 above. Chapter 6 draws on the analyses of Chapters 2 to 5 to provide answers to the first two research questions and make recommendations for nuanced improvements to Thai law, consistent with the identified path of Thai law's development and the ESV model of corporate governance, in accordance with the third research question. Chapter 7 concludes and makes suggestions for areas of further research.

CHAPTER 2
LEGAL CAPITAL RULES

2.1 Introduction

As discussed in Chapter 1, this dissertation addresses two initial research questions: are non-adjusting creditors sufficiently protected, and how has the law relating to their protection developed? These questions will be answered, respectively, using an ESV normative model of corporate governance as a yardstick, and a functional comparative analysis of Thai law against the law of two jurisdictions which heavily influenced the form of adoption of many of the Thai legal rules, England and Germany. This latter approach will include an analysis of the historical development of Thai law, comparing it to these systems in order to make nuanced recommendations which fit with the manner of evolution of the Thai legal environment relating to the protection of non-adjusting creditors.

This chapter addresses the first of four areas of legal rules which protect non-adjusting creditors identified and categorised in Chapter 1: legal capital rules, which govern the capital structure of the debtor company. First, the general role of legal capital roles in relation to the protection of non-adjusting creditors will be discussed, and a categorisation of relevant rules will be made. There follows detailed discussion of the functionally equivalent rules in each comparator jurisdiction, beginning with their historical background and development, beginning with Thai law, followed by English law then German law. Finally, before concluding, this chapter performs a comparative analysis of the three legal systems and evaluates them, addressing the two research questions of this dissertation.

2.2 Capital maintenance and protection of non-adjusting creditors

Legal capital rules may be generally described as "a set of provisions that constrain corporate activity by reference to the shareholders' capital investment."[1] The rules may be seen to fall into two categories: those which regulate how capital is

[1] Louise Gullifer and Jennifer Payne, *Corporate Finance Law: Principles and Policy* (3rd edn, Bloomsbury Publishing 2020) 150.

raised from shareholders and those which regulate how and when the capital may be returned to shareholders.[2]

The first category of rules would include, for example, a minimum amount of money that must be invested to gain access to the corporate form, sometimes called minimum capital rules. Although some scholars have argued that creditor protection is among the purposes of minimum capital rules, sustained attacks on this have been made.[3] These include that such rules do not typically require shareholders to contribute further to make up for trading losses,[4] and the amount, unlike for example capital adequacy rules, is not tailored to the risks of each business.[5] Ultimately, although there may be other supportable purposes for a minimum capital requirement,[6] it appears that it has little utility as a means of creditor protection.[7] Therefore this dissertation will focus on the other category, also known as capital maintenance rules.

The essence of the doctrine of capital maintenance is that the capital contributed to the company by the shareholders should be regarded as available for use in trading but should not, without special safeguards for creditors, be returned to shareholders before the company is liquidated.[8] Creditors may therefore rely on assets of equivalent value being available to satisfy their claims, unless the value has been reduced due to losses in trading. If it has been reduced, it must be restored to the

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[2] See ibid 115. See also Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017) 114.

[3] Marcus Lutter, *Legal Capital in Europe* (Walter de Gruyter 2011); Andreas Cahn, *Capital Maintenance in German Company Law* (Goethe-Universität, Institute for Law and Finance 2015); Luca Enriques and Jonathan R Macey, 'Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules' (2000) 86 Cornell Law Review 1165.

[4] Eilís Ferran, *Company Law and Corporate Finance* (Oxford University Press, USA 1999) 47.

[5] Peter O Mülbert, 'A Synthetic View of Different Concepts of Creditor Protection, or: A High-Level Framework for Corporate Creditor Protection' (2006) 7 European Business Organization Law Review 357, 386; John Armour, 'Legal Capital: An Outdated Concept?' (2006) 7 European Business Organization Law Review 5, 11.

[6] E.g. to act as a barrier against frivolous or nefarious incorporations of limited companies (Paolo Santella and Riccardo Turrini, 'Capital Maintenance in the EU: Is the Second Company Law Directive Really That Restrictive?' (2008) 9 European Business Organization Law Review 427, 434) or as the price that must be paid for access to the privilege of limited liability (e.g. *Ooregum Gold Mining Company of India Ltd v Roper* [1892] AC 125 (HL))

[7] Jaap Winter and others, 'Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe' (2002) <https://ecgi.global/sites/default/files/report_en.pdf> accessed 11 November 2022.

[8] Eilís Ferran and Look Chan Ho, *Principles of Corporate Finance Law* (2nd edn, Oxford University Press 2014) 242; Jonathan Rickford, 'Reforming Capital: Report of the Interdisciplinary Group on Capital Maintenance' (2004) 15 European Business Law Review 919, 928.

initial level before any distributions may be made to shareholders.[9] Thus, the concept aims to protect creditors against the risk that shareholders will withdraw their capital investment, i.e. asset dilution. However, the risk that capital will be lost in the ordinary course of business remains to be borne by creditors.

There have been a number of challenges to the efficacy of capital maintenance rules as a means of direct creditor protection in scholarship. Firstly, capital maintenance rules have been described as "crude mechanisms"[10] due to their poor design as creditor protection mechanisms. As Armour points out,[11] share capital is based on historic valuations ascribed to assets transferred to the company; as time goes on, it will become increasingly less appropriate as a condition for distributions indicating the company's financial good health. Indeed, in practice, sophisticated creditors such as banks do not make lending decisions based on figures of share capital; rather, the company's entire balance sheet and the *current* value of its assets are used since these give a far better picture of the state of the company's finances.[12]

Added to this criticism are arguments concerning the enforcement of capital maintenance rules and the risk of precluding useful capital structures. On the first point, it has been argued that the protective intention of legal capital rules generally is undermined by loopholes exploited by lawyers and accountants, given the discretion allowed by different methods of valuation.[13] On the second, it has been argued that capital maintenance rules prohibit some options for capital structures which would potentially benefit the economy.[14] For example, tech start-ups usually have little cash and a need to attract and retain talented individuals. The ability to agree compensation by way of issuing shares in return for future services, generally prohibited by capital maintenance rules, would be useful in this context.

Finally, it has been argued that flexible *ex post* standards are preferable to rigid *ex ante* rules in this area. For example, Armour[15] argues that the appropriateness of distribution restrictions will differ depending on the circumstances of the debtor

[9] Rickford (n 8) 928.
[10] Ferran and Ho (n 8) 243.
[11] John Armour, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law' (2000) 63 The Modern Law Review 355, 367.
[12] Enriques and Macey (n 3) 1186.
[13] In relation to the loopholes in the EU rules, see discussion in Rickford (n 8) 943.
[14] Enriques and Macey (n 3) 1195–6.
[15] Armour (n 5) 10.

company. If there are new opportunities that a company could exploit using further injections of equity, investors will be less willing to contribute if there are *ex ante* rules-based barriers to withdrawing their investment if it later proves not to be required. This will tend towards underinvestment. *Ex post* standards, which could apply where directors have inappropriately returned capital to shareholders in a way which prejudices creditors, would address this problem.

There have been a number of counter-arguments from proponents of capital maintenance rules, including the benefits of preventative protection, the reduction of transaction costs involved in negotiations, the prevention of value-destructive asset stripping following takeovers, reducing pressure on management to engage in short-termism, the problems that an alternative regime would cause in terms of liability for management, and even the deep roots of the concept in some jurisdictions' legal cultures.[16] However, they do not dispel the major criticisms of capital maintenance rules discussed above, which are essentially that rules based on preventing distributions to shareholders linked to their initial contribution neither ensure that funds are available to meet all categories of creditors' claims, nor provide reliable or even helpful information to voluntary creditors when deciding to extend credit to a company.

Although these attacks on capital maintenance rules' ability to protect creditors have merit, it may also be argued that the deficiencies primarily apply if capital maintenance rules are seen as a means of *direct* creditor protection. There is another way to look at their function and purpose which, although accepting a more modified scope, helps explain their form and principles in a more nuanced manner and can inform their interpretation.

A basic element of the framework of company and bankruptcy law is that creditors rank ahead of shareholders in the order of distributing a company's assets on liquidation.[17] This ranking concerns the different levels of risk assumption in the corporate structure; shareholders ultimately bear more risk than creditors. Rules which relate to capital maintenance fundamentally support this order of priorities. As

[16] See the executive summary by Marcus Lutter of an Expert Group on Legal Capital in Europe, published as a special edition of the European Company and Financial Law Review: Lutter (n 3).
[17] Eilis Ferran, 'Creditors' Interests and "Core" Company Law' (1999) 20 Company Lawyer 314, 318.

Davies puts it, "[i]t could be argued that the capital maintenance rules replicate for the company when it is a going concern the principle which applies on insolvency: shareholders are entitled to payments only if the creditors' claims have been met".[18] This principle may be referred to as '**shareholders last**'. The rules ensure that the amount of capital which the shareholders have contributed cannot be withdrawn, other than by using procedures protecting creditors' interests, until creditors' claims have been fully satisfied. On this view of their purpose, many of the criticisms of capital maintenance rules are weakened.

Therefore it may be argued that capital maintenance rules are not intended to perform the job of capital adequacy standards, or to provide an equity 'cushion' that serves as security for creditors' claims.[19] They are not intended to provide information to potential creditors about the financial health of the company. They are not intended to operate as a means of *directly* protecting creditors against the failure of a business. Capital maintenance rules simply ensure that shareholders bear the risks of the business failing in priority to creditors. In the terminology adopted in Chapter 1, they aim squarely to prevent asset dilution. On this basis capital maintenance rules are justified under the ESV corporate governance model since they support the status of shareholders as the residual claimants, a concept fundamental to this model as discussed in Chapter 1.

For convenience, this chapter will divide the discussion of capital maintenance rules into two functional categories: those applicable to "direct" reductions of capital and those applicable to "indirect" reductions of capital. Direct reductions of capital comprise overt distributions of a company's capital directly to the company's shareholders, typical examples of which are dividend distributions, share repurchases and redemptions and statutory procedures for reductions in capital. Indirect reductions of capital comprise distributions of a company's capital to shareholders by more indirect or concealed means, for example by purchasing assets from shareholders at an overvalue,[20] setting off debts owed by a company against

[18] Paul Davies, *Introduction to Company Law* (2nd edn, Oxford University Press 2010) 93.
[19] P Davies and S Worthington, *Gower's Principles of Modern Company Law* (10th edn, Sweet & Maxwell 2016) pts 11–1.
[20] As discussed below, different jurisdictions may view such transactions, to one extent or another, using rules relating to legal capital or rules relating to challenging transactions.

requirements to pay up share value, or releasing shareholders from an obligation to pay up share calls. These conceptual categories are not recognised by the laws or legal doctrine of any of the comparator jurisdictions; the division of the rules into these concepts is merely for the purpose of structuring the discussion and the comparative exercise that follows.

2.3 Thai law on capital maintenance

As discussed above, this chapter will focus on the provisions of the laws of the comparator jurisdictions which aim to ensure that capital initially contributed by shareholders to a company cannot be returned to the shareholders without safeguards to protect the interests of creditors. There are two primary sources of such provisions in Thai law, as indicated in Chapter 1: the CCC and the Offences Act. In relation to direct reductions of capital, the discussion focuses on provisions relating to paying dividends to shareholders,[21] the company repurchasing or redeeming shares from shareholders,[22] and the statutory reduction of capital procedure.[23] In relation to indirect reductions of capital, the discussion focuses on requirements to pay up calls on shares,[24] the prohibition on cancelling share subscriptions[25] and the prohibition on setting off calls on shares against debt owed by the company.[26] This section begins with a discussion of the historical background and development of these rules in Thai law, followed by analysis of the relevant provisions in relation to the shareholders last concept discussed above.

2.3.1 Historical background and development

The general background to the drafting of Book III of the CCC and the Offences Act has been discussed in Chapter 1. However, a detailed review of the specific provisions against their stated origins in the Book of Revised Drafts and notes of the draftsmen has been made, the results of which are displayed in tabular form in

[21] Primarily Sections 1201-2 of the CCC and Section 19 of the Offences Act.
[22] Primarily Section 1143 of the CCC and Section 12 of the Offences Act.
[23] Primarily Section 1224 of the CCC and Section 22 of the Offences Act.
[24] Primarily Sections 1105, 1106, 1120 and 1123-6 of the CCC.
[25] Section 1114 of the CCC.
[26] Section 1119 paragraph 2 of the CCC.

Appendix 2. Overall, the results of this research reveal the following conclusions. In spite of a wide array of provisions being cited as sources for the CCC, the rules relating to legal capital were in general adopted from German and Japanese sources, which are, in many cases, conceptually similar to each other. Some of the provisions appear to have a source in English law, although it is interesting to note that frequently the English source provision is contained in the default set of company articles under the Companies (Consolidation) Act 1908 ("CCA"), from which companies were free to depart; in the CCC, such provisions are made mandatory. Evident here also is a strong apparent influence of the Partnerships and Companies Act of 1911 and, in some cases, of the charters of companies which proceeded that Act. In relation to the Offences Act, similarly, the provisions bear heavy influence primarily of German and Japanese sources, although the detail of the wording of some of the provisions differs. Overall, the capital maintenance provisions represent a bricolage of the different sources, rather than giving any indication that one jurisdiction's approach was used as a template for the whole of the capital maintenance regime. However, the heaviest influence overall is made by German and Japanese sources.

Although the text of the CCC in this area has not been significantly amended since its promulgation, several other developments have shaped the interpretation and application of the rules. First, there are interpretations of the Supreme Court and academics, and the DBD has issued several opinions and statements concerning the interpretation and application of the provisions. Second, the Accounting Act BE 2543 (2000)[27] and the Act on Accounting Profession BE 2547 (2003)[28] have had a significant impact on the operation of the capital maintenance regime. The impact of these developments is discussed in relation to the specific rules below.

2.3.2 Direct reductions of capital

As discussed above, the typical ways in which a company may directly reduce its capital are by paying dividends to shareholders, by purchasing or

[27] Government Gazette Vol. 117, Part 41 gor., 12 May 2000.
[28] Government Gazette Vol. 121, Part 65 gor., 22 October 2004.

redeeming shares directly from shareholders and by engaging in a capital reduction procedure. The Thai rules and their interpretation in this area is now discussed.

2.3.2.1 Dividends and the reserve fund

In general, dividends may either be declared by resolution passed in a general meeting, or paid as interim dividends by the directors in such amount as appears to the directors to be justified by the profits of the company.[29] Under Section 1201 paragraph 3, only money which is considered profit may be distributed as dividends to the shareholders.[30] In addition, Section 1202 paragraph 1 requires that the company must appropriate to a reserve fund at least one twentieth of the profits of the company until the reserve fund reaches the sum of one tenth of the company's share capital, or such larger figure as may be provided in the articles of association.[31]

The CCC does not give any detail concerning the meaning or calculation of profit, which is clearly crucial for determining whether, and how much of, a company's assets may be distributed via dividends. However, it seems generally accepted that profit can only constitute money which the company has generated from business activities, rather than using borrowed money or share premium for example,[32] and profit is not calculated only across a single accounting period: losses from previous years must be made up before dividends may be declared.[33]

The determination of profits connects to relevant accounting rules. Under Section 4 of the Accounting Act, legal persons must prepare accounting reports in accordance with accounting standards,[34] which means the Thai Accounting

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[29] Sections 1201-2 CCC.
[30] See Sahaton Rathanapaichitr, *Explanation of the Principles of Partnership and Company Law* (6th edn, Winyuchon Publication House 2020) 396 (Thai language). Also, see DBD Opinion 0803/595, 30 Jan 2003.
[31] ibid 395.
[32] ibid 399; Thipchanok Ratthanosot, Explanation of Legal Provisions and Principles Relating to Partnerships and Companies (6th edn, Thammasat University 2013) 457 (Thai language); Sophon Ratanakorn, Explanation of the Provisions of the Civil and Commercial Code relating to Partnerships and Companies (12th edn, Nitibannagarn 2010) 463–7 (Thai language); Nontawach Nawathragulwisuth, Legal Principles of Partnerships, Limited Companies and Public Limited Companies (4th edn, Winyuchon Publication House 2019) 214–6 (Thai language).
[33] Ratthanosot (n 32) 453; Rathanapaichitr (n 30) 394.
[34] The power to set accounting standards is granted to the Federation of Accounting Professions ("FAP") by Section 7, 33 and 34 of the Act on Accounting Professions BE 2547. However, this Act

Standards ("TAS") issued by virtue of the Act on Accounting Profession.[35] Following the policy of the Federation of Accounting Professionals ("FAP"), TAS have been subject to adjustments to bring them into line with the International Financial Reporting Standards ("IFRS").[36] However, it is notable that IFRS, developed by the private sector London-based International Accounting Standards Board, are not intended to be applied as the basis for a capital maintenance legal framework. Rather, their aim is to provide financial information "useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity."[37] Indeed, critics of IFRS have argued that its use can lead to the distribution of unrealised profits, on the basis that it prefers the principle of true and fair view accounting rather than, for example, the principle of conservatism under German law.[38] Failure to comply with TAS is a criminal offence under the Act on Accounting Profession, and may lead to a number of other offences for companies, directors and accounting professionals as a result of a failure to prepare accounts properly.[39]

If a limited company pays dividends in contravention of Section 1201 or 1202 of the CCC, the creditors are entitled to call for the return of the dividend payments; however, a shareholder who receives the dividends honestly may not be compelled to return them.[40] Moreover, if a company pays dividends in contravention of Section 1201 or 1202, the company, directors and management commit a criminal offence under the Offences Act.[41] Notably, any amount paid or

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also gives powers to other organisations to issue rules relating to accounting standards in certain situations, including to the DBD (see ss.7, 8, 11, 14, 40).

[35] See Nares Kesaprakorn, 'The Legality of the Thai Accounting Standards: TASs' (2014) 13(2) BU Academic Review 141-151, 142.

[36] See Announcement of the Federation of Accounting Professions No. 12/2555 dated 12 May 2009, which is regarded as the starting point for bringing TAS into line with IFRS. Ibid, 146.

[37] Para 1.2 of the Conceptual Framework for Financial Reporting issued by the International Accounting Standards Board in 2010, revised March 2018 <http://eifrs.ifrs.org/eifrs/bnstandards/en/framework.pdf> accessed 11 November 2022.

[38] Bernhard Pellens and Thorsten Sellhorn, 'Improving Creditor Protection through IFRS Reporting and Solvency Tests' [2006] Available at SSRN 938156 372–4; Giovanni Strampelli, 'The IAS/IFRS after the Crisis: Limiting the Impact of Fair Value Accounting on Companies' Capital' (2011) 8 European Company and Financial Law Review 1.

[39] Section 7(3) Act on Accounting Professions BE 2547; Section 18 read with 25 and 28 of the Offences Act; Section 10 of the Accounting Act BE 2543; Sections 46, 49(3) (4) and 70 of the Act on Accounting Professions BE 2547.

[40] Section 1203 CCC.

[41] Section 19 Offences Act read with Section 25.

distributed to shareholders will be considered dividends for the purpose of criminal liability in this regard. In the event of a breach of Sections 1201 or 1202, directors may also be liable to the company for breach of their duty to properly distribute dividends under Section 1168 paragraph 2; however, if their action is approved by the general meeting, they may be relieved from liability under Section 1170.

2.3.2.2 Share repurchases and redemptions

The CCC has no provisions allowing companies to issue redeemable shares. Furthermore, companies are prohibited from owning or taking security over their own shares under Section 1143 of the CCC. Any purported legal act in violation of this provision will be void.[42] A loan by a company to a third party to buy its shares will not be invalid *per se*; however, the company cannot accept security over its own shares as collateral.[43] Under the Offences Act, a company which contravenes Section 1143 of the CCC commits a criminal offence, and the directors will also be criminally liable.

2.3.2.3 Reductions in capital

A company can reduce its registered capital only by following the process set out in Section 1224 of the TCCC. This Section provides two methods by which capital may be reduced: either by lowering the nominal amount of each share, or by reducing the number of shares issued. The legal requirements include a process by which creditors may withhold their consent to the reduction if they raise an objection within 30 days of being notified.[44] If any creditors object, the company cannot carry out the reduction unless it has repaid the debts owed to the objecting creditors or given security for at least that amount.[45] If a creditor is unaware of the plan to reduce capital through no fault of her own, shareholders remain personally liable to her in respect of any amount returned to them for 2 years.[46] Under

[42] Thai Supreme Court Decision 3848/2526.
[43] Thai Supreme Court Decisions 3119/2526 and 1560/2527. See also Ratthanosot (n 32) 320.
[44] See Section 1226 of the CCC and Ratanakorn (n 32) 484.
[45] Section 1226 of the CCC. If the creditors object, and the registrar does not allow the capital reduction to be registered, through no reasonable cause, the company may file a lawsuit to assert their right to reduce their capital. ibid 485.
[46] Section 1227.

Section 1225, a company may not reduce its capital to less than 25% of its total. Under Section 22 of the Offences Act, a failure to publish or send the notice in relation to a proposal to reduce share capital, or proceeding without satisfying objecting creditors, constitutes a criminal offence for the company and directors.

2.3.3 Indirect reductions of capital

Thai law does not generally treat indirect reductions in capital as a problem to be addressed by rules relating to capital maintenance. Instead, transactions which have the effect of reducing the assets available to creditors are addressed using the regime for challenging transactions discussed in Chapter 3. However, there are two sets of rules relating to legal capital which are relevant to indirect reductions of capital. First, there are provisions which require shareholders to pay up share calls in full and prevent the company from cancelling share subscriptions. Second, there is a prohibition on setting off calls on shares against debts owed by the company to the relevant shareholder.

2.3.3.1 Requirements to pay up calls on shares and prohibition on cancelling share subscriptions

Under Section 1105 paragraph 3, at least 25% of the nominal amount of the shares must be paid upon subscription, along with the total amount of any share premium.[47] Additionally, shares may not be issued at a discount, i.e. below their nominal value.[48] Regarding valuation, shares may either be paid up in money or they may be issued in return for a contribution otherwise than in money ("in-kind payments").[49] There are no specific requirements concerning the valuation of shares or the in-kind payments in the CCC. However, accuracy of valuation is enforced by a criminal offence under Section 48 of the Offences Act for dishonestly fixing the value of the service or property contributed. Additionally, the wide-ranging provision at Section 41 may be relevant in these circumstances,[50] which provides that a director who does or omits to do any act with intent to seek a benefit unobtainable by lawful

[47] Section 1105 paragraph 2.
[48] Section 1105 paragraph 1.
[49] Sections 1108(5) and 1221.
[50] See e.g. Thai Supreme Court Decision 5819/2562.

means for himself or for any other person and thereby causes loss to the company commits an offence.

Under Section 1120, unless otherwise decided by the general meeting, the directors may decide when to call in the balance of the payments on shares.[51] Ultimately, if shares remain unpaid, the directors may declare the shares to be forfeited and sold by public auction, the proceeds used to pay share calls and interest.[52] If the auction proceeds fall short, the original shareholder will be liable for the balance.[53] A failure to cause forfeited shares to be sold by public auction, and any failures to apply the proceeds of sale to the payment of share calls and interest and to return the balance to the shareholder, is a criminal offence under Section 7 of the Offences Act.

Under Section 1114, after a company has been registered, a subscriber for shares cannot bring a claim to court to cancel her subscription on the ground of mistake, duress, or fraud.[54] This does not prohibit a criminal case against someone committing fraud; it only prohibits the court's cancellation of the subscription under the CCC.[55] This is an exception to the general rule of contract law,[56] so that even where there is a defect in the basic requirements of intention, the law will not permit the transaction to be challenged.

2.3.3.2 Prohibition on setting off calls on shares against debt owed by the company

Under Section 1119 paragraph 2, a shareholder may not set off payments owed on share calls against payments owed to her by a company. In other words, if a company owes a shareholder a debt, the shareholder may not reduce the amount which she is obliged to contribute for her shares by the amount of the debt. Instead, she must contribute the full amount required to pay up share calls, and separately claim against the company for repayment of the debt owed to her. Section

[51] Share calls may also be made by a liquidator or receiver in bankruptcy, notwithstanding that the company was established, and an agreement to subscribe for shares signed, over 10 years previously. See Thai Supreme Court Decision 773/2532.
[52] Sections 1123-6. The balance, if any, is to be returned to the shareholder under Section 1125.
[53] Section 1106.
[54] Nawathragulwisuth (n 32) 174.
[55] See Thai Supreme Court Decisions 467-468/2513 and 979/2495. See also Ratthanosot (n 32) 278.
[56] See for example, Sections 157, 159 and 175 of the CCC: Ratanakorn (n 32) 467.

1119 paragraph 2 is generally[57] interpreted as a strict prohibition:[58] a company cannot agree privately to a contract which contradicts this provision as it concerns public order and good morals, thus falling into an exception to the general principle of freedom of contract.[59] If the parties attempt to engage in such an arrangement, the calls on the shares are deemed not to have been paid.[60]

The DBD has also issued a notification on this subject, clarifying that a company may increase its capital by issuing shares either in return for money or for property which may be used in the business.[61] However, a company may not issue shares in return for the release of a right to bring a claim. There is one exception to this prohibition, within bankruptcy law: under Section 90/42 of the BA, Section 1119 of the CCC does not apply to a business reorganisation plan under its provisions.

2.4 English law on capital maintenance

The English law rules relating to capital maintenance of private limited companies are now contained in the Companies Act 2006 ("CA 2006"), although as discussed below many of the relevant concepts were produced through the common law which is still relevant for the interpretation of many of the provisions. General rules concerning share capital are contained in Part 17,[62] which also includes alteration of a company's share capital[63] and reductions in share capital.[64] Acquisition of a company's own shares is governed by Part 18,[65] which includes general provisions,[66] redeemable shares,[67] purchase of own shares,[68] redemptions and repurchases out of capital.[69] Finally, distributions are governed by Part 23.[70]

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[57] The author has argued elsewhere, criticising this interpretation, that Supreme Court decisions on this topic are not conclusive. See Adam Reekie, 'Converting Debt into Equity in Private Limited Companies in Thailand' (2020) 63 International Journal of Law and Management 97.
[58] Thai Supreme Court Decision 777/2519; Ratanakorn (n 32) 285.
[59] Thai Supreme Court Decision 2496/2523; ibid 283.
[60] Thai Supreme Court Decision 2131/2518; ibid 285.
[61] พณ [Por Nor] 0805.04/3832 on 5 September BE 2553 (CE 2010)
[62] Sections 540-8 CA 2006.
[63] Sections 617-628 CA 2006.
[64] Sections 641-653 CA 2006.
[65] Sections 658-737 CA 2006.
[66] Sections 658-676 CA 2006.

Conforming with the discussion of the Thai law rules, this section will divide its discussion of the rules into those which address direct and indirect reductions in capital. First, however, the historical background and developments of the capital maintenance regime will be briefly discussed.

2.4.1 Historical background and development

Although the English legal rules relating to capital maintenance are now primarily contained in the CA 2006, they can be thought of as having three sources:[71] first, the rules which have their origins in the 19th century, developed predominantly through case law; second, European legislation, particularly the Second Company Law Directive (the "Second Directive");[72] and thirdly, English statutes which precede the CA 2006, but which were neither a part of earlier case law nor required by European legislation.

The story of capital maintenance in English law begins with the legislation which made incorporation of private companies possible, the Joint Stock Companies Act of 1844, which provided that registered companies could declare dividends only out of profits.[73] However, the position changed in the consolidated legislation of the Companies Acts of 1856 and 1862, in which this restriction appeared only in the default articles of association attached to the Acts, from which companies were free to depart. In addition, the Companies Act 1862 did not expressly prohibit a company from reducing its share capital. However, the decision in the case of *Droitwich Patent Salt Co v Curson*[74] held that to allow a company to freely reduce its capital was inconsistent with the concept of limited liability. The 1862 Act was

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[67] Sections 684-689 CA 2006.
[68] Sections 690-708 CA 2006.
[69] Sections 709-723 CA 2006.
[70] Sections 829-859 CA 2006.
[71] Gullifer and Payne (n 1) 119.
[72] Second Council Directive 77/91/EEC of 13 December 1976.
[73] This was clarified by the Companies Consolidated Clauses Act of the following year, Section 151, which specifically described that a company may not make a dividend which reduces its capital stock, being the minimum value of its net assets raised initially and, so far as possible, retained in the business. Dean Ardern and Maxwell Aiken, 'An Accounting History of Capital Maintenance: Legal Precedents for Managerial Autonomy in the United Kingdom' (2005) 32 Accounting Historians Journal 23, 28.
[74] [1867] LR 3 Ex 35.

amended by s.9-20 of the Companies Act 1867, which introduced a court-supervised capital reduction procedure.[75]

Case law concerning the doctrine of maintenance of capital only emerged decades after these statutory developments in response, it has been suggested, to the need to protect creditors in the context of limited liability.[76] Leading cases decided in this period included *Trevor v Whitworth*[77] in 1877 and *Re Exchange Banking*[78] in 1882. The former established a complete prohibition on a company purchasing its own shares, while the latter established the principle that bad debts had to be accounted for before declaring dividends. However, exceptions and circumstances where capital could be returned to shareholders grew through numerous legislative amendments from the late 19th and throughout the 20th century.[79]

Throughout this period, case law also tended to incrementally grant flexibility for companies to return capital to shareholders. For example, in a much discussed[80] case of *Lee v Neuchatel Asphalte Company*,[81] Lindley LJ indicated that how dividends were to be paid and how profits calculated were 'very judiciously and properly...left to the commercial world'[82] and that 'it is not a subject for an Act of Parliament to say how accounts should be kept'.[83] Similar flexibility was shown through decisions such as *Ammonia Soda Co Ltd v Chamberlain*,[84] which held that past losses did not have to be recovered before paying dividends out of current profits, and *Dimbula Valley (Ceylon) Tea Co., Ltd v Laurie,*[85] which held that dividends could

[75] This permitted a company to petition the court to reduce its capital, and the court had discretion to approve the reduction taking into consideration objections of creditors who had not yet been satisfied.
[76] EA French, 'The Evolution of the Dividend Law of England' in WT Baxter and S Davidson (eds), *Studies in Accounting* (Institute of Chartered Accountants of England and Wales 1977) 306.
[77] (1877) 12 App Cas 409.
[78] (1882) 21 Ch D 519. See also *Ooregum Gold Mining Co of India v Roper* [1892] AC 125.
[79] For example, in 1877, reduction of capital was permitted when it was no longer represented by assets; in 1947, companies were allowed to issue redeemable preference shares, and in 1981 companies were allowed to purchase their own shares.
[80] For an overview of the debates, see Christopher Nobes, 'Accounting for Capital: The Evolution of an Idea' (2015) 45 Accounting and Business Research 413.
[81] (1889) 41 Ch D 1.
[82] Per Lindley LJ at 21.
[83] Ibid. Capital was to be understood as the assets rather than the ownership inputs and then restricted to its circulating and not fixed elements. See Ardern and Aiken (n 73) 48; French (n 76) 315.
[84] (1918) 1 Ch 266.
[85] (1961) Ch 353.

be paid out of unrealised capital profits arising from a *bona fide* revaluation of fixed assets.[86]

The tide flow towards flexibility was, in part, halted after the Companies Act 1980 came into force, implementing the Second Directive which had drawn on a German precedent.[87] Overturning a number of previous English court decisions, this, together with the Companies Act 1981, set out a statutory test of what constitutes distributable profit and linked concepts such as 'realised profits' and 'realised losses' for the first time to accounting rules. However, the Second Directive also required Member States to allow public companies to purchase their own shares, which the UK extended also to private companies through the Companies Acts of 1980 and 1981, also permitting the issue of redeemable shares.

The CA 2006, following an extensive review of the existing legal capital regime,[88] resulted in a number of important amendments including, as discussed below, linking the ability for a company to reduce its capital or repurchase its shares to standards of directors' behaviour rather than a balance sheet determination. Overall, the development of English law's approach to capital maintenance, from the strict interpretation in the cases which started the doctrine, has tended to incrementally embrace flexibility and to increasingly rely on standards of directors' conduct rather than accounting rules to determine how much of the company's assets can be returned to shareholders.

2.4.2 Direct reductions of capital

To assist with the functional analysis which will follow, this section divides the different methods of directly returning capital to shareholders along the same conceptual lines as the discussion in relation to Thai law: paying dividends to

[86] Nobes argues that the conceptual confusion regarding dividends and capital in England may be rooted in the fact that different kinds of enterprises themselves originally used different accounting methods: merchants used double entry bookkeeping and could calculate profits by reference to capital; monasteries, aristocratic estates, and then railway and canal companies used a style of accounting focused on operating receipts, without reference to capital. Nobes (n 80).
[87] CW Nobes, 'The Evolution of the Harmonising Provisions of the 1980 and 1981 Companies Acts' (1983) 14 Accounting and Business Research 43.
[88] Company Law Review Steering Group, 'Modern company law for a competitive economy: company formation and capital maintenance,' Cmnd 1144 (1999).

shareholders, purchasing or redeeming shares from shareholders, and engaging in a capital reduction procedure.

2.4.2.1 Dividends

There are two sources of rules relating to dividend payments in the English legal system: the statutory provisions which are found in Part 23 of the CA 2006 and the common law rules which operate in tandem.[89] Under the common law, the general principle may be stated as being that a distribution of assets to a shareholder, except in accordance with specific statutory procedures laid down for the purpose, is a return of capital which is unlawful and *ultra vires* for the company.[90] Under the CA 2006, the general rule from Section 830 is that a company may only make distributions out of profits available for the purpose, i.e. the company's "accumulated, realised profits, ... less its accumulated, realised losses".[91]

Section 853(4) of the CA 2006 provides that references to 'realised' profits and losses means 'realised' in accordance with generally accepted accounting principles at the time when the accounts are prepared.[92] The directors of a company have the responsibility for preparing accounts for each of its financial years which give a 'true and fair view', and have choice between using Financial Reporting Standards published by the Financial Reporting Council ("UK GAAP"), or IAS Accounts prepared in accordance with IFRS as adopted in the EU ("EU IFRS").[93]

Under Sections 845 and 846 of the CA 2006, companies are permitted to make distributions of non-cash assets ("distributions in kind") to shareholders. The amount of the distribution will be calculated by reference to the value at which the assets are recorded in the accounts, i.e. book value.[94] If an asset is transferred to a shareholder in exchange for the same or more than book value, there

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[89] Gullifer and Payne (n 1) 133.
[90] *Trevor v Whitworth* (1877) 12 App Cas 409.
[91] Section 830(2) CA 2006.
[92] Section 836(1) CA 2006. In some circumstances, initial or interim accounts may be used instead: Section 836(2).
[93] Section 393 CA 2006.
[94] This is an example where the choice between UK GAAP and IFRS may make a difference on the ability to make distributions in kind. IFRS requires 'fair value' valuations, whereas UK GAAP permits book value to be used, typically making it easier to make distributions in kind. See ICAEW Technical Release TECH 02/17BL para 2.9.

is no distribution; however, if the company has no distributable profits and makes a distribution of an asset at below book value, this constitutes an unlawful distribution.

Pursuant to Sections 851 and 852 of the CA 2006, restrictions on distributions imposed by common law override the statutory provisions. As a result, if further losses have occurred since the accounts were prepared which would result in dividends being paid out of capital, this may be considered an unlawful act on the part of the company.[95] In addition, the directors owe fiduciary and other duties in the exercise of their powers, and therefore subsequent losses or even an expectation of future trading losses after the distribution of dividends is a matter to be taken into account in making the decision.[96]

If a dividend is paid in breach of these rules, the receiving shareholder is personally liable to repay the dividend, but only if she knows, or has reasonable grounds for believing, that the payment breached the dividend rules.[97] There is no criminal liability.[98] In respect of directors, although the CA 2006 provides no specific liability, the common law position is preserved: under the rule in *Re Exchange Banking,*[99] directors who cause the company to pay unlawful dividends are under a duty to restore to the company the value of the assets wrongly paid away. A debated issue is whether this is strict liability or requires fault.[100] The best view appears to be that the liability is strict, but subject to the court's discretion to grant relief where a director has acted honestly and reasonably under Section 1157 of the CA 2006.[101]

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[95] Davies and Worthington (n 19) 286.
[96] However, shareholders may in principle ratify a breach of directors' duties, ibid. See also accounting guidance published by the ICAEW, Tech 02/10, paras 2.4–2.5
[97] Section 847(2) CA 2006 The knowledge requirement on the part of the recipient is limited to knowledge of the facts giving rise to the contravention of the rules: *It's a Wrap (UK) Ltd v Gula* [2006] EWCA Civ 544. Liability under the common law also preserved, on the basis that the recipient is a constructive trustee of an *ultra vires* distribution, however the test is similar if not the same as under the CA 2006: ibid 292.
[98] ibid.
[99] *Re Exchange Banking* (1882) 21 Ch D 519.
[100] Davies and Worthington (n 19) 293; Charles Wild and Stuart Weinstein, *Smith and Keenan's Company Law* (17th edn, Pearson UK 2016) 382.
[101] *Re Paycheck Services 3 Ltd* [2010] UKSC 51, at [45-47] (Lord Hope), [124] (Lord Walker), and [146] (Lord Clarke), all *obiter*.

2.4.2.2 Share repurchases and redemptions

The general rule is that a limited company is not permitted to acquire its own shares.[102] A breach of this rule constitutes a criminal offence by the company and every officer who is in default.[103] However, the CA 2006 includes important exceptions to this general rule, both in relation to repurchases[104] and redemptions of shares.[105]

Under the CA 2006, a company may purchase its shares using distributable profits or using the proceeds of a fresh issue of shares made for the purpose.[106] However, the CA 2006 also includes a process which permits shares to be repurchased from capital.[107] The procedure requires a directors' statement and auditors' report, approval by a special resolution of shareholders, and public notice of the proposed payment or a notice in writing to each creditor, who may object within 5 weeks.[108] The directors' statement is to certify that, having made appropriate enquiries, there are no grounds on which the company would be unable to pay its debts and that, in respect of the next 12 months, it is their opinion that the company will be able to carry on its business as a going concern and continue to pay its debts as they fall due.[109] If directors make the solvency statement without reasonable grounds for their opinion, they commit a criminal offence.[110] In addition, if the company is wound up within a year of the payment, the person whose shares are repurchased and the directors who signed the statement are liable to contribute to the company's assets.[111] Directors will be excused liability if they show that they had reasonable grounds for forming the opinion, for example by relying on the auditors' report.[112]

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[102] *Trevor v Whitworth* (1887) 12 App Cas 409; s. 658(1) CA 2006.
[103] Section 658(2) and (3) CA 2006.
[104] Sections 690-708 CA 2006.
[105] Sections 684-689 CA 2006.
[106] Section 692 CA 2006.
[107] Section 709 CA 2006. This procedure may only be used where profits or the proceeds of a fresh issue of shares are unavailable for this purpose.
[108] Sections 714-720 CA 2006.
[109] Section 714(3) CA 2006; this is backed up by an auditors' opinion which must state that the auditor is not aware of anything to indicate that the directors' statement is unreasonable (714(3) CA 2006).
[110] Section 715 CA 2006.
[111] Insolvency Act 1986, s.76(2).
[112] Insolvency Act 1986, s.76(2)(b)

The same concepts that apply to financing repurchases of shares apply to redemptions of shares.[113]

After the purchase, the shares may either be held as treasury shares or treated as cancelled, resulting in the amount of the company's issued share capital being reduced by the nominal value of the shares.[114] The amount by which the company's issued share capital is reduced is transferred to a reserve account called the capital redemption reserve[115] which, for most purposes, is treated as though it is share capital.[116] Thus, the bar for making distributions out of profit in the future is not lowered by a repurchase or redemption of shares.

2.4.2.3 Reductions of capital

The CA 2006 allows a company's capital to be reduced by two processes: first, with the sanction of the court and, second, in an out-of-court process supported by a directors' solvency statement. [117] Under the court process, if the proposal involves either the release of liability in respect of unpaid share calls or the repayment to a shareholder of paid-up share capital, the creditors are entitled to object to the reduction.[118] Objecting creditors must show that there is a real likelihood that the reduction would result in the company being unable to meet her claim.[119] A court will only approve the proposed reduction if it is satisfied that the objecting creditors' consent has been obtained, or the debt has been discharged or secured.[120] If an officer of the company intentionally or recklessly conceals from the court the

[113] Section 687 CA 2006; The difference between repurchases of shares and share redemptions is that for the latter the terms on which they may be redeemed are usually included in the company's articles and the decision to redeem them may, if the terms allow, not require consent of both parties: Sections 684-5 CA 2006.
[114] Section 706 CA 2006; redeemed shares are treated as cancelled: Section 688 CA 2006.
[115] Section 733 CA 2006.
[116] The exception is that it may be used to pay up new shares allotted to members as fully paid-up bonus shares under Section 733(5) CA 2006.
[117] Section 641 CA 2006; The company has wide discretion in the manner in which it may reduce its capital, and the CA 2006 specifically refers to extinguishing or reducing liability on its shares in respect of capital not paid up, cancelling any paid-up capital that is lost or unrepresented by available assets, or repaying to shareholders any paid-up share capital in excess of its needs: Section 641(4)
[118] Section 645 CA 2006; the court can direct that creditors are entitled to object to the proposal in other cases – see s.645(4) CA 2006.
[119] Section 646 CA 2006.
[120] Section 648 CA 2006.

names of creditors entitled to object or misrepresents the nature of a debt, she commits a criminal offence.[121]

The out-of-court process requires a special resolution and a solvency statement similar to that required for repurchases of shares funded out of capital discussed above.[122] The statement must be made by all directors, and failure to have reasonable grounds for the opinion constitutes a criminal offence.[123] However, in this context there is no requirement for an auditor's report to support the directors' solvency statement, or any requirement to publicise the reduction by notifying creditors or public announcement, and no formal mechanism for creditors to raise objections. Although initial research revealed that many companies preferred the more expensive and time-consuming court procedure due to the personal liability for directors attached to the solvency statement,[124] later research suggests growing popularity for the out-of-court procedure.[125]

2.4.3 Indirect reductions of capital

Since the case of *Trevor v Whitworth*,[126] discussed above, the courts have consistently taken the approach that it is *ultra vires* for a company, without sanction by the court or by a statutory procedure, to return its capital to shareholders. Indeed, courts have similarly recognised that it is *ultra vires* to give away a company's capital to third parties gratuitously, other than in furtherance of the company's objectives.[127] However, as discussed further in Chapters 3 and 4, English law generally views such transactions as challengeable through insolvency law or as giving rise to liability for directors through wrongful trading. The exceptions to this are requirements on shareholders to pay up share capital and a line of cases concerning disguised distributions, which will now be discussed.

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[121] Section 647 CA 2006.
[122] Section 643 CA 2006.
[123] Section 643(4) CA 2006.
[124] Infogroup/ORC International, 'Evaluation of the Companies Act 2006, volume one: Report to the Department for Business, Innovation and Skills' (2010) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/fle/31655/10-1360-evaluation-companies#act-2006-volume-1.pdf> accessed 27 July 2019, 117-119
[125] Weightmans, 'The solvency statement: reducing share capital' (2017) <https://www.weightmans.com/insights/the-solvency-statement/> accessed 27 July 2019.
[126] (1887) LR 12 App Cas 409.
[127] E.g. *Brady v Brady* [1989] AC 755.

2.4.3.1 Requirements to pay up share capital

Under Section 580 of the CA 2006, consistent with the 19th century case law,[128] a company cannot issue shares gratuitously or at a discount from their nominal value, and if shares are issued at a premium this must be paid up too. The sum due may be paid in money, which includes forgiving a liquidated debt,[129] or money's worth (i.e. non-cash consideration), which includes goodwill and know-how.[130] In relation to valuation of non-cash consideration, much latitude is granted: since the 19th century case of *Re Wragg Ltd*[131] it has been recognised that a company is entitled to issue shares for non-cash consideration provided it does so honestly and that the valuation of the transaction was not made "colourably". The question of what is colourable is a matter of fact for each case.[132] The general position, from the case of *Ooregum Gold Mining Co of India Ltd v Roper,*[133] is that provided the company honestly regards the payment as representing the nominal value of the shares in cash, the valuation ought not to be critically examined.

It is usual for a company's articles of association to cover the procedures involved in making calls for paying up shares, liability of members to pay calls when asked, and forfeiture of unpaid shares.[134] Unpaid shares may be forfeited by a board resolution only if an express power to do so is given in the articles, and the object of the forfeiture must be for the benefit of the company.[135] Even though the effect of forfeiture of shares is to reduce a company's capital, the sanction of the court is not required: a power in the articles is sufficient.[136] Where the articles are silent, the former shareholder is discharged from liability and no action can be brought against

[128] Re Wragg Ltd [1897] 1 Ch 796; Ooregum Gold Mining Co of India Ltd v Roper [1892] AC 125; Re Eddystone Marine Insurance Co [1893] 3 Ch 9.
[129] An extended definition of what constitutes 'allotted for cash' is included in Section 583 of the CA 2006, and covers cash, cheques, a release of liability for a liquidated sum, an undertaking to pay cash at a future date, and payment by any other means giving rise to a present or future entitlement to payment, or credit equivalent, in cash.
[130] Section 582 CA 2006.
[131] [1897] 1 Ch 796.
[132] *Re Innes & Co Ltd* [1903] 2 Ch 254 at 262.
[133] [1892] AC 125 at 137.
[134] Wild and Weinstein (n 100) 284.
[135] As opposed to allow a shareholder to avoid liability for the payment of calls where the shares have fallen in value: see *Re Esparto Trading* (1879) 12 Ch D 191.
[136] Wild and Weinstein (n 100) 288.

her unless the company is wound up within one year. In that case, they may be called upon to pay the calls unless a subsequent holder of those shares has paid them.[137]

2.4.3.2 Disguised distributions

The statutory rules on distributions apply to "every description of distribution of a company's assets to its members, whether in cash or otherwise."[138] Furthermore, the common law rules preventing distributions to be made out of capital are preserved, and for these purposes the label the parties give to the transaction is not determinative.[139] As a result, if the court characterises a transaction as a distribution and determines that it has been made out of capital, it may hold the transaction to be void.

For example, in *Re Halt Garage (1964) Ltd,*[140] the court found that sums paid to a director in excess of what she was entitled to in the articles and at a time that the company was insolvent were intended to be a disguised distribution to the owner and should be treated as though they were dividends.[141] Since there were no distributable profits, these distributions were *ultra vires* and void. In *Aveling Barford Ltd v Perion Ltd,*[142] a sale of property by a company which had no distributable profit at a significant undervalue to another entity controlled by the company's sole beneficial shareholder was held to be an unlawful distribution. The important principle here is that, where a company has no distributable profits, transactions within the corporate group may be held to violate capital maintenance rules if they are considered distributions.

More recently, in 2010, the Supreme Court considered this issue again in the case of *Progress Property Co Ltd v Moorgarth Group Ltd*,[143] which concerned a company selling the shares in its subsidiary to another company within its corporate group at an undervalue. The undervalue was the result over a

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[137] ibid.
[138] Section 829 CA 2006; this is subject to a specific list of exceptions in Section 829(1).
[139] Progress Property Co Ltd v Moorgarth Group Ltd [2010] UKSC 55; Aveling Barford Ltd v Perion Ltd [1989] BCLC 626; Ridge Securities v IRC [1964] 1 All ER 275.
[140] [1982] 3 All ER 1016.
[141] Per Oliver J, "The real question is, were these payments genuinely director's remuneration? If your intention is to make a gift out of the capital of the company, you do not alter the nature of that by giving it another label and calling it 'remuneration'". Ibid.
[142] [1989] BCLC 626.
[143] [2010] UKSC 55.

misunderstanding over an indemnity believed to be owed by the subsidiary company. The issue was whether the sale should be characterised as a distribution based on an objective test, or whether the intentions of the parties were relevant. The Supreme Court held that the court's real task was to inquire into the true purpose and substance of the transaction, in which the state of mind of the persons orchestrating the transaction could be relevant.[144] The correct determination was whether the transaction was a genuine arm's length transaction, or an improper attempt to extract value by the pretence of an arm's length transaction: in the latter case, it would be unlawful.

2.5 German law on capital maintenance

The German law rules relating to capital maintenance of private limited companies are contained in the GmbH Act although, as discussed below, many of the relevant concepts were developed through judicial interpretation. The general rules concerning share capital are contained at Section 5 of the GmbH Act, with payment of capital contributions governed by Section 19 (and Section 55 and following sections for capital increases after formation) and rules relating to over-valuation of contributions in kind are set out in Sections 9 to 9c. Forfeiture of shares and the related procedure is addressed at Sections 21-4. The central provision relating to capital maintenance is Section 30, with consequences of breach covered by Sections 31-2. The ability for a company to purchase its own shares is detailed at Section 33. Rules relating to a company's balance sheet are contained at Section 42 and following sections. Sections 58-58f govern the reduction of capital procedure and, finally, Section 82 includes some important relevant criminal offences.

Conforming with the discussion of the Thai law rules, this section will divide its discussion of the rules into those which regulate direct and indirect reductions in capital. Before this, however, the historical background and developments of the capital maintenance regime in German law will be briefly discussed.

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[144] Ibid at 24.

2.5.1 Historical background and development

Before 1870, a concession was generally required to create a company in Germany.[145] However, following general incorporation in 1870,[146] there was a stock market bubble, which burst in the mid 1870s, for which some critics blamed provisions of the 1870 Act for allowing seriously under-capitalised companies to be created for the profit of promoters.[147] The 1884 Corporations Act[148] introduced rules intended to protect investors and creditors. In particular, the reforms emphasised the preservation of capital.[149] However, the rigidity of this legislation made the business form of the corporation particularly unsuitable for smaller firms.[150] Its fixed capital system also posed a particular problem in respect of Germany's colonial activities following the mid 1880s: the need to predict in advance the amount of capital a project would require was especially unsuitable in the context of the uncertainties of building and operating businesses in new colonies. No colonial firms were established under the 1884 Corporations Act; instead, all were charter companies.[151] Ultimately the GmbH was created in 1892 with additional flexibility as regards raising legal capital – real assets and intellectual property could be used to make capital contributions with no requirement for independent external evaluation – but there were still strict capital rules intended for the protection of creditors.[152]

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[145] Timothy W Guinnane, 'German Company Law 1794-1897' in Harwell Wells (ed), *Research handbook on the history of corporate and company law* (Edward Elgar Publishing 2018) 175.

[146] In 1870 the North German Confederation relaxed the rules on formation of corporations that were governed by the *Allgemeines Deutsche Handelsgesetzbuch*, prior to which legislation had been made concerning corporations related to railroads in 1838, and corporations in general in 1843. See ibid 171.

[147] Timothy W Guinnane, 'Creating a New Legal Form: The GmbH' (2020) Yale University Economic Growth Center Discussion Paper.

[148] Gesetz betreffend die Kommenditgesellschaften auf Aktien und die Aktiengesellschaften.

[149] A corporation had a fixed number of shares and could not be incorporated until all those shares were subscribed for. A new corporation needed at least 5 shareholders, each with at least one share of 1000 Marks, and registration required at least 25% of the capital to be paid up. Increasing the corporation's capital by issuing new shares was difficult, and the only practical method of raising capital was to call for more paid-up capital on outstanding shares, which existing shareholders could resist. See Guinnane (n 145) 192–3.

[150] Even larger firms went to extreme lengths to avoid being considered a 'corporation' for the purposes of the 1884 Corporations Act, for example by attempting to organize themselves as mining firms which were allowed to use a specific more flexible business form, an example which was mentioned in the notes to the GmbH Act. See Guinnane (n 147) 8.

[151] ibid 11.

[152] The GmbH included minimum capitalisation rules analogous to that of corporations under the 1884 Corporations Act and if any owner failed to make his required contributions, the other shareholders had to make up the difference – see e.g. Sections 9, 24, 31 and 59 of the GmbH Act.

Although the GmbH dates back to 1892, the text of the GmbH Act was not significantly amended until 2008.[153] The reform, initially as a small-scale attempt to address abuse in the vicinity of insolvency, grew into a more wide-spread modernisation programme in response to increasing use of the English limited liability company form by German businesses.[154] The amending legislation – the MoMiG[155] – primarily aimed at facilitating the incorporation process. However, it also made a number of important amendments to the capital regime. For the purposes of this chapter, these include changes to the regime relating to valuation of non-cash capital contributions[156] and to the rules relating to dividend distributions.[157] As discussed in more detail below, the changes made by the MoMiG have moved the capital maintenance framework some way towards relying on guarantees made by shareholders rather than actual contributions and standards of directors' conduct rather than *ex ante* capital maintenance rules.

2.5.2 Direct reductions of capital

As discussed above in relation to both Thai law and English law, the typical ways in which a company may directly reduce its capital are by paying dividends to shareholders, by purchasing or redeeming shares directly from shareholders, and by engaging in a capital reduction procedure. Similarly to the analysis of the Thai and English legal regimes above, these will be discussed in turn in relation to German law.

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[153] There were several amendments in relation to Germany's co-determination laws between 1951-1976, some amendments relating to minimum capital, contributions in kind and shareholder loans in 1980, and amendments to minimum capital rules in 2005. See Enno W Ercklentz, 'The GmbH Law Amendments of 1980' [1981] The International Lawyer 645, 645–7; Klaus J Müller, *The GmbH: A Guide to the German Limited Liability Company* (Verlag CH Beck 2006) 2–3.

[154] Thomas Bachner, Creditor Protection in Private Companies: Anglo-German Perspectives for a European Legal Discourse (Cambridge University Press 2009) 15.

[155] Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen ("MoMiG")

[156] These include reducing the situations where registration may be refused for differences between stated and actual values of contributions in kind, and removing the requirement for a guarantee in relation to in kind contributions made to single member companies, both of which may be seen to make it easier to incorporate companies. See Sections 7, 8, 9c, and 19 GmbH Act.

[157] Michael Beurskens and Ulrich Noack, 'The Reform of German Private Limited Company: Is the GmbH Ready for the 21st Century?' (2008) 9 German Law Journal 1069, 1079.

2.5.2.1 Dividends

The core rule of capital maintenance is set out at s.30 para 1 of the GmbH Act, which provides that funds necessary to maintain the company's registered capital must not be paid to the shareholders. In other words, for a GmbH to make a distribution, it must have assets sufficient in value to cover both liabilities and the amount of the registered share capital. The capital maintenance rules are violated if payments to shareholders result in the GmbH getting into a state of deficit (*Unterbilanz*). 'Payments' within the meaning of the capital maintenance rules includes not only cash transfers but all transactions by which the assets of the company decrease to the benefit of the shareholder. A notable feature of the GmbH regime is that the return of amounts contributed in addition to the nominal capital amount, i.e. share premium, is not restricted.[158] In other words, funds provided by shareholders in excess of the nominal value of the shares may be returned to the shareholders without going through a formal capital reduction procedure.

The determination of distributable profits depends largely on the application of accounting principles. The applicable German accounting principles are found in the commercial code, the *Handelsgesetzbuch* ("HGB"), which uses a principle of conservative valuation, a realisation principle and lowest value principle for assets. This, combined with a principle of highest valuation for liabilities, generally results in a lower valuation of assets and a higher valuation of liabilities than application of 'true and fair view' accounting.[159] For example, under the HGB, assets may not be recorded at higher value than their historical acquisition cost.[160] Therefore the balance sheet may not reflect the true value of assets that appreciate in value, such as land, rather than depreciating assets. Thus, the application of the HGB will generally result in a calculation of distributable profits which is lower than under IFRS, for example, as discussed above in relation to Thai and English law.

Furthermore, since the MoMiG amendments, the directors are liable in respect of payments to shareholders which render the company cash-flow insolvent, unless a prudent and diligent director would have been unable to foresee the

[158] Bachner (n 154) 110.
[159] Andreas Cahn and David C Donald, Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA (Cambridge University Press 2010) 225.
[160] Cahn (n 3) 8.

company's insolvency.[161] Therefore, even transactions with a shareholder at full value, for example, may violate capital maintenance provisions if the payment received by the company is less liquid than the assets transferred to the shareholder.

If payments have been made to shareholders in breach of the capital maintenance provisions, the receiving shareholder must repay the relevant amount to the company.[162] If the recipient was acting in good faith, reimbursement may only be requested to the extent required to pay creditors.[163] If reimbursement cannot be made by a shareholder, the other shareholders will be liable in proportion to their shares.[164] Claims may also be brought in parallel under the law of unjust enrichment[165] and directors may be subject to criminal sanctions for breach of trust (*Untreue*).[166]

2.5.2.2 Share repurchases and redemptions

A company may purchase its own shares provided that they are fully paid up and the purchase payment is made out of funds exceeding those necessary to cover the registered share capital of the company.[167] Similarly, the company may take its shares in pledge if the total amount secured by those shares is not greater than the amount of assets exceeding the registered share capital amount.[168] Fully paid-up shares may be redeemed if this is expressly permitted in the company's articles of association.[169] The result of a redemption is that the redeemed shares cease to exist, together with all rights and obligations attached to them.[170] However, the

[161] Section 64 paragraph 3 GmbH Act.
[162] Section 31 GmbH Act.
[163] Section 31(2) GmbH Act.
[164] Section 31(3) GmbH Act.
[165] BGH Judgment of 27 November 2000 (BGHZ 146), 105.
[166] D Weber-Rey and J Schneider, 'Thin Capitalisation Rules and Maintenance of Capital for German Limited Liability Companies' (1993) 4 International Company and Commercial Law Review 217, 218. See Section 266 of the Criminal Code.
[167] Section 33 GmbH Act.
[168] ibid.
[169] BGH Judgment of 9 December 2002 (II ZB 12/02, BGHZ153) 158. The exiting shareholder is entitled to compensation; the remaining shareholders are obliged to ensure that the company is able to pay the compensation or dissolve the company: BGH Judgment of 10 May 2016 (II ZR 342/14).
[170] Müller (n 153) 103.

amount of the registered capital of the company is left untouched by the redemption.[171]

2.5.2.3 Capital reductions

Reductions of registered capital must follow the procedure and comply with the requirements laid down by section 58 of the GmbH Act. The capital decrease may not result in the registered share capital of the company falling below the EUR 25,000 statutorily required minimum capital figure. The resolution on the decrease of registered share capital must be published in three consecutive issues of the company's journals.[172] This publication must ask creditors to make their claims to the company and, if they do not consent to the reduction of capital, the company must satisfy their claims.[173] Additionally, the company must contact directly in writing creditors whose addresses are known to the company. The company may apply for registration of the reduction of capital no earlier than the first anniversary of the date on which this publication has appeared for the third time.[174] The court scrutinises the application *ex officio*, but creditors are not party to the court proceedings.[175] However, there is a simplified capital reduction procedure where the reduction will not pay out funds to shareholders, but rather serve to recognise a loss in capital. In these situations, the rules seeking to protect creditors of the company in an ordinary capital reduction do not apply, including the right to demand that claims are satisfied and the one-year waiting period.[176]

There are rules governing when profits may be distributed to shareholders following a capital reduction, which require that capital reserves and retained earnings must exceed 10% of the registered capital if distributions are to be made within 5 years of the capital reduction.[177] Additionally, payment of over 4% per share in profit is only permissible within 2 years of the capital reduction if creditors

[171] ibid 104.
[172] Section 58 GmbH Act.
[173] Ibid.
[174] ibid.
[175] Bachner (n 154) 108.
[176] Section 58a GmbH Act.
[177] Section 58d paragraph 1 GmbH Act.

who object within 6 months after publication of the relevant annual financial statements are indemnified or repaid.[178]

2.5.3 Indirect reductions of capital

Unlike Thai and English law, German law will in many cases treat transactions that have the indirect result of reducing the assets of a company and increasing the assets of shareholders with the application of capital maintenance rules. In particular, the German courts have developed the concept of disguised distributions in relation to transactions with shareholders, directly or indirectly, that result in value being transferred away from the company. After discussing requirements for shareholders to pay up share capital, as for Thai law and English law, this section discusses such disguised distributions, including loans to and from shareholders, which are viewed by German law through the prism of capital maintenance.

2.5.3.1 Requirements to pay up share capital

Under Section 19 paragraph 2 of the GmbH Act, a company and a shareholder may not enter into an arrangement that would result in the shareholder being relieved from paying up her outstanding share contributions. Furthermore, a shareholder may not set off any counterclaims that she may have against the requirements to contribute capital to the company.[179] If a shareholder fails to make the required contribution, her shares may, after a warning letter and a grace period of at least one month, be declared forfeit.[180] In such case, the shareholder continues to be liable for the outstanding amount,[181] and this liability will also potentially fall on previous owners of the shares.[182] If it is not possible to obtain payment from predecessors, the company may sell the share by public auction.[183] If

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[178] Section 58d paragraph 2 GmbH Act.
[179] However, the company may elect to engage in such a set off provided that the claim of the shareholder is due for payment and the value corresponds to the nominal value. See BGH Judgment of 21 February 1994 (II ZR 60/93).
[180] Section 21 GmbH Act.
[181] Section 21(3) GmbH Act.
[182] Section 22 GmbH Act. Any predecessor in title is also liable for outstanding amounts on the forfeited share, to the extent that amounts cannot be raised from successors, and if a predecessor pays the outstanding amount, she acquires the share.
[183] Section 23 GmbH Act – although this is not required if there is no reasonable prospect of having the share sold at a public auction: *OLG Köln,* Judgment of 23 June 1993 (2U 118/92); Müller (n 153) 70.

the auction fails to raise the required capital contribution, the remaining shareholders are liable, proportionately according to their ownership, for the payment of the outstanding amount.[184] Moreover, if for any reason, at the time that the company is registered, there is a shortfall in the total amount of net assets compared to the nominal value of shares, the shareholders are liable for the balance.[185]

The requirement for a shareholder to make a contribution in cash cannot be fulfilled by a contribution in any other form.[186] However, capital can be contributed in kind both on the establishment of the company and on later capital increases.[187] Shareholders must prepare a report presenting the information relevant to assess the value of in-kind contributions on formation. There is no requirement for an audit by external auditors, but the shareholders may be liable for damages[188] and may face criminal charges[189] in the case of misrepresentations.

The German courts have developed the doctrine of 'hidden contributions in kind' (*verdeckte Sacheinlagen*). If capital contributions are required to be made in cash, an arrangement which results in the company receiving something from the shareholder other than cash will not satisfy the obligation. This will be the case where there is a connection between the cash contribution of a shareholder and a transaction between the company and the shareholder through which the shareholder receives cash from the company.[190] A simple example is where the shareholder contributes cash to the company, and the company then uses the cash to purchase an asset from the shareholder. However, the concept is broad and includes loans made by the company to a shareholder, for example.[191] If there is no evidence, such an agreement is presumed to exist if the related transaction occurs within a certain period of time following the contribution.[192] The consequences of such an arrangement are

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[184] Section 24 GmbH Act.
[185] BGH Judgment of 9 March 1981 (II ZR 54/80); BGH Judgment of 16 March 1981 (II ZR 59/80); Müller (n 153) 70.
[186] Section 19 paragraph 5 GmbH Act.
[187] Sections 5(4) and 56 GmbH Act.
[188] Section 9a GmbH Act.
[189] Section 82(1) 2 GmbH Act.
[190] A hidden contribution in kind will arise if there is an agreement between the shareholder and the company that closely ties the cash contribution and the related transaction: Müller (n 153) 68.
[191] ibid.
[192] Courts and legal authors debate what would be the appropriate time period, with advocated periods ranging from 6 months to 2 years. See ibid.; Schöpfin, *Die Lehre von der verdeckten Saheinlage* (The

that the obligation to pay cash has not been fulfilled by the shareholder; the shareholder must still pay up the cash contributions. However, the German courts have interpreted the law in a way which makes it possible to retrospectively cure hidden contributions in kind through passing appropriate resolutions.[193]

2.5.3.2 Disguised distributions and shareholder loans

The German courts have developed a broad concept for challenging transactions which have the result of passing value from a company to shareholders as disguised distributions.[194] This is based on a single provision relating to capital maintenance, Section 30 of the GmbH Act, which will be violated in any transaction with a shareholder where inadequate value is received for the goods or services provided by the shareholder. Adequacy of value is judged against a hypothetical agreement that would have been entered into with a third, unrelated, party on the same terms and conditions, with leeway granted by applying the business judgment of a diligent and prudent director.[195] The concept of disguised distributions also applies to transactions involving third parties, where the economic benefit of the distribution accrues to the shareholder. For example, arrangements using agents or nominees as middlemen between the company and the shareholder may be considered disguised distributions, as will transfers to companies in which the shareholder owns a controlling interest.[196]

Into this concept will also fall loans granted by a company to a shareholder on non-market terms, such as at a low rate of interest.[197] In what has been referred to as the "November judgment" in 2003, the BGH held that, for capital

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doctrine of hidden capital contributions in kind), GmbHR 2003, 57, 62; BGH, Judgment of 18 February 1991.

[193] BGH judgment of 3 March 1996 (II ZB 8/95); BGH Judgment of 26 May 1997 (II Z 69/96); The procedure, essentially, is to retroactively change the articles of association by a resolution to re-qualify the cash contributions into contributions in kind and to demonstrate that the contributions in kind actually made had the full value of the nominal amount of the relevant shares. See ibid 69.

[194] Cahn (n 3) 6.

[195] OLG Köln AG 2009, 584, 587; OLG Koblenz AG 2007, 408, 409; Generally accepted accountancy principles can be used to give guidance as to whether a prudent and diligent director would have agreed to the terms - OLG Koblenz AG 2007, 408, 409.

[196] BGH NZG 2008, 106; OLG Hamburg AG 1980, 275, 278.

[197] Similar considerations apply to a company giving assets as security for loans provided to shareholders. OLG Koblenz AG 1977, 231; OLG München AG 1980, 272; OLG Düsseldorf AG 1980, 273, 274; OLG Hamburg AG 1980, 275, 278.

maintenance purposes, loans to shareholders were to be assessed as though the company did not have a claim for repayment; in other words, such loans were viewed, for capital maintenance purposes, as gifts.[198] The legislature took steps to address this decision, which had significant implications for cash pooling in corporate groups, with the MoMiG. This amended Section 30(1) of the GmbH Act to provide that a loan to a shareholder will not have this effect so long as the claim for repayment is 'unimpaired' (*vollwertig*). The courts have subsequently indicated that the relevant test for whether a shareholder loan is impaired is if there is a 'concrete probability of default' (*konkrete Ausfallwahrscheinlichkeit*).[199]

2.5.3.3 Shareholder loans substituting for equity

In principle, advancing funds to a company by way of debt rather than through shares has the advantage, for shareholders, that in the event of business failure, the loans may be recovered by the same process as other corporate creditors; equity, in similar circumstances, would be lost. The German legislature and courts[200] have developed rules that limit the use of shareholder loans to some extent, where such loans may be considered as 'substitute for equity' (*Kapitalersatz*).

Prior to amendments made by the MoMiG, a loan was considered to be a substitute for equity if it is given when the company is in financial crisis.[201] Following the amendments made by the MoMiG, *any* loan extended by a shareholder is subordinated in the case of insolvency proceedings.[202] Furthermore, the insolvency administrator's right of avoidance applies to all repayments that were made over the year prior to, or at any time after, the filing of the insolvency petition.[203] Decisions of the courts also demonstrate an intention to interpret the

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[198] BGH, Der Konzern 2004, 196. The court based its decision on the arguments that deferred claims for repayment were not as useful, from a creditor protection point of view, as liquid assets and that the company's creditors lost priority in their claims over the shareholder's personal creditors.
[199] Cahn (n 3) 9.
[200] This concept was developed based on s.30 and 31 GmbH Act and first appeared in the 'Lufttaxi' case of the BGH in 1959 (BGH Judgment 14 December 1959, BGHZ 31, 258 at 271) See Bachner (n 154) 139.
[201] Müller (n 153) 83.
[202] See Sections 39 (1) n. 5, 39 (4) and (5) of the InsO. The previous Sections 32a and 32b GmbH Act were repealed, and a new sentence was inserted in s30 (1) GmbH Act, which disapplies this section to shareholder loans to prevent future development of the case law in this area along the previous line.
[203] Section 135 of the InsO.

concept widely, extending this treatment to loans provided by indirect shareholders and to shareholder loans assigned to third parties within a year prior to filing an insolvency petition.[204]

2.6 Comparative analysis and evaluation

This section compares the three jurisdictions' approaches to creditor protection by way of capital maintenance rules in light of the analysis of each jurisdiction above. This section, after a comparison of the historical development, compares the rules relating to direct and indirect reductions of capital, respectively. The final part of this section evaluates the approach of Thai law against the principles of creditor protection based on an ESV approach to corporate governance as discussed in Chapter 1.

2.6.1 Comparative analysis

The review of the historical development of the three jurisdictions reveals quite differing relationships with the concept of capital maintenance. Although both England and Germany adopted the doctrine in the second half of the 19th century, their subsequent evolution took very different paths. English law has been in a state of continual incremental evolution, both through case law and legislative development, which has tended towards flexibility and relying on directors' standards of conduct. Germany, where legal capital rules were in the spotlight during the adoption of the first laws on private limited companies, retained stricter rules and judicial interpretation for over a century before a more recent overhaul with the MoMiG. Thai law, like German law, has not much altered the basic rules since their adoption. However, developments such as the link with accountancy legislation and opinions issued by the DBD have reinforced a stance which appears to favour *ex ante* rules supported by criminal penalties rather than relying on standards of directors' conduct as discussed below.

[204] BGH Judgment of 21 February 2013 (IX ZR 32/12).

2.6.1.1 Direct distributions

In relation to direct reductions of capital, there are a number of points of difference between the three jurisdictions. First, in Germany share premium is not considered to be part of the capital maintenance regime; it is only the figure represented by the nominal capital of shares which must be maintained. England and Thailand treat share premium, for most purposes, as share capital which cannot be returned to shareholders. Second, the jurisdictions differ in their accounting treatment. Thai law is tied to IFRS which, as discussed, was not designed with a legal capital maintenance regime in mind. England too, since 1980, links dividends available for distribution to accounts, but there is a choice for UK private companies between UK IFRS and UK GAAP, which allows for flexibility. In Germany, by contrast, profits are calculated by reference to the HGB, which has a principle of conservatism as opposed to the 'true and fair view' of IFRS, and which therefore may result in fewer funds available for distribution to shareholders.

A third key conceptual difference, in relation to distributions, is that in both English law and German law even properly prepared accounts are not the final word on the amount that may be distributed. Rather, in both of these systems the directors must have regard to the future solvency of the company in the period following the distribution of the dividends. Rather than capital maintenance rules only considering whether the amount of capital contributed by shareholders is being returned to them in priority to creditors, a consideration of solvency looks to preserve the business of the company, and protect creditors, in the long term. This additional, forward-looking solvency-based, requirement tied to standards of directors' conduct is not present in Thai law. However, this may arguably be balanced by the Thai law requirement, not present in English or German law, of the accruing 10% legal capital reserve which must be filled before distributions are paid. This could be seen as an attempt to account for losses potentially incurred between the preparation of accounts and the payment of dividends.

A fourth significant difference between the systems is in relation to remedies in respect of a breach of distribution rules. In Thai and English law, shareholders who honestly receive distributions in breach of capital maintenance rules will not be compelled to return them; instead, liability falls on directors, Thai

law focusing on criminal liability and English law on civil liability. By contrast, German law confers potentially significant liabilities on shareholders, including joint liability and potential liability for previous shareholders.

Thai law retains a complete prohibition on a company repurchasing, redeeming, and taking its own shares as security, which accords with initial English common law position. However, both English and German law now permit this to be done out of distributable profits, whereas English law takes the important further conceptual step of allowing repurchases and redemptions to be done out of a company's capital. Here, directors' standards via the solvency statement are relied upon to protect creditors.

In relation to capital reduction procedures, there is spectrum in terms of the control granted to creditors over the procedure. German law generally stands at one end, with a very lengthy period for creditors to object to the process, although this is streamlined where distributions will not be made, with forward-looking restrictions also in relation to when a company may return to paying dividends. Thai law, too, gives much control to creditors over the process, although the objection period is much shorter and there are no forward-looking restrictions. At the other end of the spectrum lies English law, which only grants a forum for creditors to object in the court procedure and offers an out-of-court procedure which relies entirely on directors' standards via the solvency statement. Indeed, in this context the solvency statement does not need to be supported by an auditors' report, unlike share repurchases and redemptions.

2.6.1.2 Indirect reductions

In relation to the three jurisdictions' requirements to pay up share capital, there is also a spectrum in terms of flexibility for companies and shareholders. In terms of the amount of share value that must be paid up on issue, English law has no requirement and therefore shareholders need not contribute any capital until demanded by the company and shares may be forfeited with few consequences for shareholders. By contrast, Thai law and German law have strict requirements in this area: Thai law requires 25% of the nominal value and the full amount of any premium, whereas German law has a specified minimum capital figure

of EUR 25,000 for the GmbH legal form which must be paid up on formation. Liability, in both systems, may continue in the case of forfeiture.

In relation to the valuation of assets contributed as payments for shares in kind, English law gives wide latitude to businesses to value such assets, in cases where there is no dishonesty, and Thailand similarly has no provisions in this regard although it is notable that, once again, a dishonest valuation confers criminal liability. German law, by contrast, requires shareholders to make a report of the information relevant to the assessment of the calculation, and inaccuracy may lead to both civil and criminal liability.

The concept of disguised distributions attracts different treatment among the three jurisdictions. German law, at one end of the spectrum, through broad judicial development of the concept, views any transaction, or series of connected transactions, between the company and shareholders as a disguised distribution where it results in a net transfer of assets away from the company. Next on the spectrum in English law which, although it takes a wide view of which transactions may be caught, requires finding intention to distribute a company's assets to the shareholders. At the other end of the spectrum is Thai law which will only treat as dividends the direct passing of cash to shareholders following the relevant procedure. Thai law will generally not recharacterise transactions by which value is indirectly passed from the company to its shareholders as disguised distributions. The exception to this is in the application of criminal law: under Section 19 of the Offences Act, a limited company which pays dividends, widely interpreted, in contravention of the capital maintenance rules at Sections 1201 and 1202 commits a criminal offence.

Finally, German law has adopted the concept of equity substituting shareholder loans, where contributions to a company by shareholders made through debt are subordinated to the other creditors' claims if they are made during the period before insolvency. This concept is not present in either Thai or English law.

2.6.2 Evaluation of Thai law

As discussed in part 2.2 above, capital maintenance rules are best understood as reinforcing the shareholders last principle, that shareholders should not be repaid in priority to creditors. A strong reinforcement of this principle is fundamental to the theoretical underpinnings of the ESV approach to corporate governance. Shareholders are identified as the group whose interests should ultimately be served on the basis that they are the company's residual claimants. The shareholders last principle reinforces this status.

Thai law has several notable features which do not fit with the shareholders last concept. First, Thai law has a complete prohibition on share repurchases and redemptions. While this is not inconsistent with the principle of shareholders last, it goes beyond what is required. There is no reason, from this perspective, why shares may not be repurchased, provided that the funds used to do so are profits which would otherwise be available for distribution, the financial health of the company is not jeopardised, and the share capital figure is not reduced going forward, for example by creating a corresponding capital reserve. Indeed, this is permitted by both English and German law.

A second feature of Thai capital maintenance rules which does not fit with the shareholders last concept is the requirement to contribute at least 25% of a share's nominal value on issue. The shareholders last concept does not require that any specific amount be contributed by shareholders; only that shareholders are not permitted to withdraw their investment until creditors' claims have been satisfied. Although this requirement could be viewed similarly to the minimum capital rules in German law, for example, as discussed above this does not have a significant creditor protection function; this is particularly the case here as the 25% figure does not include a requirement to reach any specific sum and therefore appears arbitrary.

A third feature is the approach in Thai law to calculating distributions relying only on accounts, and the requirement to fill a 10% reserve fund at distributions. Fundamentally, the shareholders last concept does not support trapping any particular sum in a company beyond the initial amount contributed by shareholders. However, this requirement may be viewed together with the fact that dividends may be distributed in full reliance on accounts. A balance sheet is, by

nature, a historic view of the company's finances, reporting the results of a company's operations over a specific period. If a company is permitted to distribute all profits shown in a set of accounts, this does not take into account subsequent trading losses, and therefore capital may be unknowingly distributed to shareholders in breach of the shareholders last principle. The 10% reserve could be seen as an attempt to address this problem.

However, it is notable that this is not a tailored approach to this issue; 10% could be too much or too little, depending on the circumstances of the company involved. It is notable that both English and German law take a different approach here: the balance sheet must be combined with a consideration made by the directors of whether losses have been incurred and whether the company will continue to be solvent after the distributions have been made. Indeed, it is submitted that Thai law could be reinterpreted in a similar manner. Section 1201 of the CCC states that dividends may only be paid out of profits and that losses must be made good before dividends are paid. Rather than tying this to previous accounts, it is argued that this should be interpreted to refer to the company's position at the time dividends are actually paid, and 'losses' should include those incurred after the preparation of the company's accounts. The responsibility for this calculation is on the company directors, since Section 1168(3) gives them the specific duty of the proper distribution of dividends as prescribed by law. In practice, ensuring that all trading losses are precisely taken into account at the moments of declaration and distribution of dividends would be impractical if not impossible since a precise understanding of the financial position of a company is not generally ascertainable minute-to-minute or even day-to-day. The details of the proposed reinterpretation of the regime addressing these issues are set out in Chapter 6. However, a requirement to take into account subsequent losses would be a significant step in improving Thai law's adherence to the shareholders last concept, and thereby creating a view of protection of non-adjusting creditors that accords with the ESV model of corporate governance.

A further interesting feature arising from the comparative exercise is the German concept of shareholder loans substituting for equity, not present in English or Thai law. This development is an extension of the concept of shareholders last to cover contributions made by shareholders regardless of whether as equity or

debt. From the point of view of non-adjusting creditors, this has the benefit of prioritising their claims to those of shareholders in all events. Conceptually, therefore, this requirement fits with the ESV model of corporate governance and could be considered for inclusion in Thailand's insolvency regime. However, this would represent a major change in the legal treatment of corporate debt, and therefore careful assessment of its impact would be required: for example, it may result in shareholders being less willing to advance funds to companies in crisis situations.

2.7 Conclusion

This chapter has addressed this dissertation's two opening research questions of whether non-adjusting creditors are sufficiently protected and how the law relating to their protection has developed, in relation to legal capital rules. Initially, this chapter analysed the role that legal capital rules play under the ESV view of corporate governance, the yardstick for evaluating the approach of Thai law established in Chapter 1. As discussed, the most convincing justification for legal capital rules from a creditor protection perspective is to reinforce the status of shareholders as the residual claimants through the principle of shareholders last: ensuring that shareholders receive only the balance of a company's assets after all other groups are satisfied.

Against this background, a comparative analysis was performed across the three jurisdictions, including a comparison of the manner in which the rules have developed. Although both English law and German law adopted the concept of capital maintenance in the second half of the 19th century, their evolution took very different paths. Capital maintenance continued to be central to the German approach, which used it as a basis to develop broad creditor protection concepts such as disguised distributions and shareholder loans substituting for equity. English law, by contrast, gradually adopted more flexibility and less reliance on balance sheet tests for capital maintenance, increasingly relying instead on directors' standards of conduct, now by way of a solvency statement approach in many areas. Thai law, by contrast has not relied heavily on capital maintenance or developed similar broad concepts as in German law, which inspired many of its capital maintenance rules, nor moved to an

approach which relies on directors' standards of behaviour. However, a notable feature of Thai law's approach is to rely on a number of criminal offences to ensure compliance with the capital maintenance regime. Thus, the comparative analysis has revealed not only a number of differences of detail in the operation of the legal frameworks, but also more fundamental differences in the approaches of the comparator systems.

In relation to the evaluation of Thai law's approach to capital maintenance in relation to principles based on the ESV approach, the analysis reveals a number of areas of inconsistency detailed above. Recommendations, which will be elaborated on in more detail in Chapter 6 in relation to the third research question, include, ideally, revising the law to permit share repurchases from profits, abandoning the requirement to contribute 25% of shares' nominal value and all premium on issue, and revising the interpretation of calculating funds available for distribution to require losses incurred subsequent to the preparation of accounts to be included in the calculation. With this interpretation adopted, the requirement for building and maintaining the 10% capital reserve could be abandoned.

As a result, the analysis performed in this chapter has posed answers to both initial research questions, on the basis of which nuanced recommendations for the improvement of Thai law have been outlined and will be dealt with in more detail in Chapter 6 in relation to the third research question. Chapter 3 will now perform a similar exercise in relation to the second category of rules, those relating to challenging transactions.

CHAPTER 3
CHALLENGING TRANSACTIONS

3.1 Introduction

This chapter examines the second category of rules which offer protection to non-adjusting creditors of private limited companies: those which allow creditors, or others on their behalf, to challenge transactions made by debtor companies. Transactions in this category include both transactions which result in the net movement of assets away from the company, sometimes called 'fraudulent transactions' or 'transactions at an undervalue', and those which result in a particular advantage to one creditor at the expense of the others: so-called 'preferences' or 'preferential transactions.' It should be noted at the outset that the conceptual difference between these categories is not always present in the doctrine of legal systems: many civil law systems follow a model using a single avoidance action, which covers any harmful action, including both preferences and fraudulent transactions; common law systems tend to follow a model which divides the actions between these categories.[1] This chapter adopts the structure of the double avoidance model, since this is present in Thai law for the historical reasons discussed below.

In a similar manner to Chapter 2, this chapter will address the two initial research questions of, first, whether non-adjusting creditors of private limited companies are sufficiently protected by the law relating to challenging transactions and, second, how the law relating to challenging transactions has developed. An ESV normative model will be used as the yardstick to evaluate the legal regime, to address the first question, and a comparative analysis focusing on the development of Thai law will be adopted in relation to the second research question, in order to permit the formation of nuanced recommendations for the improvement of Thai law in this area in accordance with the third research question.

This chapter will proceed as follows. The first section will examine the concept of challenging transactions and the theoretical and conceptual link to the

[1] See e.g. discussion in Aurelio Gurrea-Martínez, 'The Avoidance of Pre-Bankruptcy Transactions: An Economic and Comparative Approach' (2018) 93 Chicago-Kent Law Review 711, 715–6.

protection of non-adjusting creditors. The second, third and fourth sections will examine challenging transactions in each of the comparator jurisdictions in turn. The discussion and analysis in these sections will follow the same structure, for convenience: the historical background and developments in each jurisdiction, creditors' power to challenge transactions, the insolvency office holder's power to challenge transactions, and preferential transactions. Finally, before concluding, this chapter performs a comparative analysis of the three legal systems and an evaluation, addressing the two initial research questions of this dissertation.

3.2 Challenging transactions and protection of non-adjusting creditors

The transactions which may be subject to challenge by creditors, or by an insolvency officer on their behalf, may be split into two categories: so-called 'fraudulent' or undervalue transactions on one hand, and preferences on the other. The former are inappropriate transfers of assets from a company to a third party which reduce the total value of the company's assets against which creditors may claim. The latter are transactions made to some creditors in preference to the others: for example, paying one creditor their debt in full when there are insufficient funds to meet the claims of all creditors, or granting security to an unsecured creditor. Neither category of transaction generally causes harm to creditors when a company is fully solvent. However, this is not the case where the company is unable to fully pay all of its debts.

The availability of avoidance actions may operate to, *ex ante,* ameliorate through the effect of deterrence or, *ex post*, reverse opportunistic behaviour of debtors.[2] In effect, the purpose behind avoidance actions may be seen as aligning, to some extent, the incentives of debtors in financial difficulties with their creditors as a whole. This alignment has been justified by some commentators on the basis that when a company is factually insolvent but not yet in a formal bankruptcy procedure,

[2] John Armour, 'Transactions at an Undervalue' in John Armour and Howard Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Bloomsbury Publishing 2003) 46; Douglas G Baird and Thomas H Jackson, 'Fraudulent Conveyance Law and Its Proper Domain' (1985) 38 Vanderbilt Law Review 829; Thomas H Jackson, 'Avoiding Powers in Bankruptcy' (1984) Stanford Law Review 725; Robert Charles Clark, 'The Duties of the Corporate Debtor to Its Creditors' (1977) 90 Harvard Law Review 505.

the creditors have become the residual claimants but do not yet have the control over the debtor company via an insolvency office holder.[3]

The ability to challenge both fraudulent transactions and preferences may prevent opportunistic behaviour that results in harm to creditors, as discussed in Chapter 1, particularly asset dilution. Challenging fraudulent transactions addresses this directly by unwinding or reversing the effect of transactions which dilute the value in the debtor company; reinforcing the 'anti-dilution' principle.[4] By contrast, preferential transactions do not reduce the net asset value of the debtor company. The relative ratio of assets and liabilities of the company remains the same before and after the preferential transaction. However, it upsets the concept that creditors must share rateably in the assets of the debtor, sometimes known as the '*pari passu*' principle.[5]

Such behaviour is also prevented through the deterrent effect created, where debtors and counterparties are aware that such transactions are vulnerable to challenge. This deterrent effect is particularly important, since it can effectively recruit third parties as monitors of the debtor's behaviour, becoming gatekeepers who preserve the assets of the company for the benefit of creditors.[6] Put simply, if a counterparty, when purchasing an asset from a company, is aware that transactions at below full market value are vulnerable to subsequent challenge, she will likely ensure that she pays full market value for the asset. From the creditors' point of view, this has the benefit of maintaining the total value of the company's assets, which can be divided among creditors if the company later fails.

The ability to challenge preferential transactions also plays an important part in addressing, at an early stage, the 'common pool' problem, which for some theorists is the fundamental economic justification for insolvency law.[7] The power to

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[3] George G Triantis and Ronald J Daniels, 'The Role of Debt in Interactive Corporate Governance' (1995) 83 California Law Review 1073; Douglas G Baird and Thomas H Jackson, 'Bargaining after the Fall and the Contours of the Absolute Priority Rule' (1988) 55 The University of Chicago Law Review 738.

[4] Royston Miles Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell 2011) 219.

[5] Michael G Bridge, 'Collectivity, Management of Estates and the Pari Passu Rule in Winding Up' in John Armour and Howard Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Oxford University Press 2003) 1–4.

[6] Armour (n 2) 47; Triantis and Daniels (n 3).

[7] Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986).

challenge fraudulent and preferential transactions has the advantage of protecting the interests of both the debtor company and smaller creditors in the face of pressure which may be brought to bear by others when a company is in financial difficulty. In particular, a company may typically be pressured by powerful creditors to repay credit early or to sell assets at a low price in order to retain liquidity and to avoid being put into formal insolvency proceedings. The existence of avoidance powers reduces the incentive to engage in such behaviour.

However, a tension is created in respect of genuine rescue attempts. Where avoidance law prevents a company from selling assets quickly, which typically would mean at a discount, this closes off an important option for a company in financial difficulty from continuing to trade in the hopes that its financial situation will improve. Furthermore, in respect of preferential transactions, the ability to grant security may be essential to attracting financing in difficult times: the high risks for lenders may make the transaction impossible to countenance, from their perspective, without it. However, the preferential position it grants to the lender may put the transaction at risk of challenge.

Indeed, the ability for creditors to claw back assets which have been transferred away from the debtor company also faces a fundamental conflict with preserving legal certainty in commercial transactions. Where otherwise perfectly legally valid transactions are open to future challenge, there is the potential for harm to innocent counterparties. From a policy perspective, the harm caused by legal uncertainty must be balanced against the benefits generated by discouraging or reversing opportunistic behaviour or value-destroying transactions prior to insolvency.

Situating this discussion within the context of the first research question of this dissertation, the ESV model of corporate governance is premised on the concept of the shareholders as the residual claimants, as discussed in Chapter 1. However, when a company has debts greater than its assets, i.e. is balance-sheet insolvent, the creditors arguably become the residual claimants of a company.[8]

[8] Paul Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' (2006) 7 European Business Organization Law Review 301, 311; Clark (n 2); Rizwaan Jameel Mokal, *Corporate Insolvency Law: Theory and Application* (Oxford University Press 2005) 306–7.

Furthermore, when a company is balance-sheet insolvent it may not yet be in formal insolvency proceedings, which requires further administrative steps to implement. Therefore, at this time creditors, although having already attained the status of residual claimants, do not have the control over the company or the protections granted by formal insolvency proceedings. Moreover, as discussed in Chapter 1, the debtor company's managers and shareholders have significant incentives to engage in opportunistic behaviour at the expense of creditors, particularly where there is an overlap or close connection between the two – typically the case in private limited companies.[9]

As a result, from an ESV point of view, rules allowing creditors, or an insolvency office holder on their behalf, to challenge transactions are justified on the basis that the creditors become residual claimants of the debtor company when it is factually balance-sheet insolvent. Such challenges reverse the impact of inappropriate transfers on the debtor's assets, and the deterrent effect of the right to challenge transactions mitigates the incentives of shareholders and managers to behave opportunistically when a company is in financial difficulty.

Furthermore, the right to challenge preferential transactions has a notable impact when it comes to the protection of non-adjusting creditors. All creditors have an incentive to enforce their claims for repayment as soon as there is indication of the borrower company's financial distress, in the hope of a better chance to make a full recovery: this leads to the 'common pool' problem of a value-destructive race between different claims.[10] Corporate insolvency law must address this problem with an orderly process involving a moratorium on the execution of claims. However, powerful secured and adjusting creditors have the incentives and means to improve their position when a company encounters financial difficulties: employing contractually agreed monitoring rights, for example, they may become aware of the debtor company's financial position and use the threat of enforcing their security or petitioning for bankruptcy to compel the debtor to repay their debt or grant (further) security to improve their position in formal insolvency proceedings. The ability to

[9] See discussion in Chapter 1.
[10] Jackson, *The Logic and Limits of Bankruptcy Law* (n 7); Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale Law Journal 857.

challenge preferential transactions addresses this risk and therefore operates to protect non-adjusting creditors who would be prejudiced by this behaviour.[11] As some commentators have noted, the right to challenge preferences is not concerned with the size of the 'pie' of the debtor's assets, but how it is divided.[12] Ultimately, the power to challenge preferential transactions is essential in preserving the order of distribution in formal bankruptcy proceedings, which could otherwise be manipulated by pre-bankruptcy preferential transactions.

Overall, a regime which makes it very easy to successfully challenge transactions will prioritise maximising the assets of a company in bankruptcy, theoretically increasing the insolvency dividend for all creditors, including non-adjusting creditors. However, this will be at the expense of legal certainty, potentially discouraging transactions and credit of all kinds and therefore harming economic activity and growth in the economy as a whole. A regime which makes it very difficult to successfully challenge transactions will have the opposite effect, including reducing the deterrent effect that a credible challenging transactions regime creates. Furthermore, there are also normative concerns of protecting good faith innocent parties to consider.

This chapter will now discuss the regime in relation to challenging transactions of the three comparator systems, before comparing and evaluating each regime, addressing the first research question of this dissertation. The discussion of each system's regime will begin with an examination of its historical development, addressing the second research question.

3.3 Challenging transactions in Thai law

In Thai law, transactions may be challenged either by creditors themselves before formal bankruptcy proceedings have been initiated, or by the insolvency office holder on their behalf if the debtor company has entered formal

[11] Although some commentators have noted that the design of the law in this area often does not create an effective incentive, since reversing the effect of the transaction without sanction makes the preferred creditor no worse off than they would have been without the preferential transaction. See e.g. Adrian Walters, 'Preferences' in John Armour and Howard Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Bloomsbury Publishing 2003) 136–8.
[12] Goode (n 4) 571.

bankruptcy proceedings.[13] Creditors may challenge so-called fraudulent transactions by way of Section 237 of the CCC. The insolvency office holder has two routes of challenge: fraudulent transactions, similarly to creditors, by virtue of Section 113 of the BA, and also preferential transactions taking place during the three months prior to formal insolvency proceedings under Section 115 of the BA.

However, the insolvency office holder's powers are enhanced, in relevant circumstances, by presumptions or extended time periods. Where the fraudulent act either arose within the one-year period prior to the bankruptcy petition, constitutes a gratuitous act or an act under which the debtor received unreasonably small remuneration, the insolvency office holder may bring a claim under Section 114, in which it benefits from a favourable presumption regarding proof of the required mental element. In relation to preferential transactions, where the advantaged creditor is the debtor's insider, the three-month period is extended to one year prior the bankruptcy petition, under Section 115 paragraph 2. The historical background to these provisions will now be discussed, before further analysis of their interpretation and application.

3.3.1 Historical background and developments

The general background of the adoption of the CCC and the BA has been discussed in Chapter 1. In addition, as discussed in Chapter 2, a detailed review of the specific provisions against their stated origins in the Book of Revised Drafts and notes of the draftsmen has been made, the results of which are displayed in tabular form in Appendix 2. Regarding the right to challenge fraudulent transactions, under Sections 237-40 of the CCC, a wide variety of sources are referenced, including Japanese and Italian codes and the abortive 1923 Siamese civil code; the drafting notes for the latter also include a list of Dika Court judgments, as well as references to Egyptian, French, Italian, Japanese and Tunisian codes.[14] Although ultimately the

[13] In relation to insolvency proceedings, the BA contains has procedures for insolvent liquidation and business reorganisation. The regime for challenging transactions is identical under both procedures. For convenience, the discussion in this chapter refers only to challenging transactions in insolvent liquidation (s.113-6), but the same analysis applies to business reorganisation under s.90/40-90/41, *mutatis mutandis*.

[14] Draft Civil and Commercial Code, Archive of the Office of the Juridical Council, Roll 9, 1311 (1910).

provision most closely resembles Japanese sources, the wide variety of references witnesses the fact that the legal concept is a common one among continental European systems, and legal systems which have been influenced by them. Indeed, it traces its origins to a Roman law procedure which has come to be known as the *actio pauliana*.[15] This was based on two elements: first, the prejudice to creditors produced by the reduction of the debtor's assets; second, the debtor's intention to defraud her creditors and the collusion with the counterparty. Collusion was not required in the case of a gratuitous conveyance, based on the principle of *nemo liberalis nisi liberatus*. Furthermore, the *actio pauliana* was available both to individual creditors and to the *curator bonorum* in bankruptcy, the Roman insolvency office holder.[16]

The *actio pauliana* describes a triangular pattern of relationships. On one axis is the relationship between the creditor and the debtor, and on another is the relationship between the debtor and the counterparty to a transaction. The *actio pauliana* completes the triangle, by allowing the creditor to bring a claim against the counterparty in order to achieve a return of the property.[17] The *actio pauliana* represents a balancing exercise between the relative weight of the interests represented by the creditor-debtor relationship and the debtor-counterparty relationship respectively. Notably, however, the English law concepts for challenging fraudulent transactions have a different origin, in the Statute of 13 Elizabeth 1 of 1571 (the "Statute of Elizabeth"),[18] which has its intention the prevention of fraud.[19] Rather than balancing the interests of the different relationships, the focus of the provision is on only the intention of the debtor. The counterparty's *bona fides* and the provision of valuable consideration are merely a defence. The *actio pauliana* model, conversely, requires some kind of collusion between the debtor and the counterparty for the creditors to successfully exercise their rights.

As argued elsewhere by the author, the predecessors of Sections 113-114 and 115 of the BA – Sections 45-6 of the Bankruptcy Act RS 130 (1911) –

[15] Ilaria Pretelli, 'Cross-Border Credit Protection Against Fraudulent Transfers of Assets: Actio Pauliana in the Conflict of Laws' (2011) 13 Yearbook of Private International Law 589, 591.
[16] ibid 593–4; Max Radin, 'Fraudulent Conveyances at Roman Law' [1931] Virginia Law Review 109.
[17] There is some uncertainty about the doctrinal nature of the relationship created by the *actio pauliana*, i.e. whether it is an obligation or the enforcement of a special lien: see Pretelli (n 15) 599.
[18] However, some academics argue that the principles were present in the common law long before even this: Armour (n 2) 38.
[19] Baird and Jackson (n 2) 829.

were inspired by English law, in particular Sections 47-8 of the Bankruptcy Act 1883.[20] The provisions in the BA appear to have evolved directly from the above provisions in the Bankruptcy Act RS 130 (1911),[21] albeit linking up Section 113 with Section 237 of the CCC.[22] Moreover, the relevant provisions in the BA have been amended several times since their enactment in 1940. Initially, the period for challenge under Section 114 was three years prior to the petition of the debtor, extended from two years under the Bankruptcy Act RS 130 (1911), and cancellation only applied to transfers of property. The court had the power to cancel the transaction unless the counterparty could show that she received the property honestly and in exchange for good value, concepts inspired by the English legislation mentioned above. In 1968 this was revised to include other acts, rather than being restricted only to transfers.[23] Moreover, in 1999 the part of the BA relating to challenging transactions was more fundamentally amended:[24] Sections 114-116 were revised into their present form. Rather than an independent action, Section 114 became linked to Section 113, creating a presumption of existence of the mental element in the three circumstances discussed below. The period of challenge was also reduced from three years to one, and the link with Section 237 incorporated the requirement for causing loss to the debtor, to allow counterparties to rely more easily on the certainty of transactions to conduct their businesses.[25] Furthermore, the 1999 amendment extended the period for challenging preferential transactions from three months to one year where the counterparty is the debtor's insider, recognising the special risks posed by transactions with connected parties. In 2018, an additional paragraph was added to Section 113 to insert a limitation period of one year from the

[20] Adam Reekie, 'Challenging "Fraudulent" Transactions and Protecting Company Creditors in Thailand: A Comparison with English and German Law' (2019) 37 Chulalongkorn Law Journal 135.
[21] See discussion of evolution in Faculty of Law, Thammasat University (Prof. Sahaton Ratthanapaijitr et. al.), 'Research Report Concerning Project to Improve the Enforcement of Bankruptcy Cases in accordance with International Standards' 7 (Thai language); Sombun Rugitganpanit, 'Problems and Obstacles for Enforcing Section 115 of the Bankruptcy Act BE 2483 on the Avoidance of Preferential Transactions' (LLM Thesis, Faculty of Law, Thammasat University 1995) 16–19 (Thai language).
[22] See Annex 2.
[23] Bankruptcy Act (No 2) 2511 (1968).
[24] Bankruptcy Act (No. 5) 2542 (1999).
[25] Faculty of Law, Thammasat University (Prof. Sahaton Ratthanapaijitr et. al.) (n 21) 275–6.

time when the cause of cancellation became known to the insolvency office holder or 10 years from the commission of the act.[26]

It is interesting to note that tying the right for the insolvency office holder to challenge fraudulent transactions in the BA to Section 237 of the CCC effected a change in the ancient source: from a medieval English law predecessor intended to combat fraud to a Roman law predecessor which aimed to balance the weight of interests in different relationships. Indeed, this is notable as the BA was itself generally heavily influenced by the English Bankruptcy Act 1914, and the predecessors to the rules on challenging transactions were themselves influenced by earlier English legislation.[27] This section will now analyse the current legal provisions.

3.3.2 Creditors' power to challenge transactions

The right to challenge fraudulent transactions generally in Thai law is set out in Sections 237-240 of the CCC. These provisions form part of Book II of the CCC on obligations, specifically Part IV of Chapter II which concerns the results of obligations. A successful challenge will result in the return the property to the ownership of the debtor, for the benefit of all creditors.[28] The right is generally referred to as a right to challenge fraudulent (ฉ้อฉล [*chochon*]) transactions. However, this terminology is potentially misleading. If the act is done with deceptive intention (กลฉ้อฉล [*gonchochon*]) the juristic act would be voidable under Section 159 of the CCC.[29] For a successful claim under Section 237, the following four elements must be made out:

(1) First, the debtor must have performed a juristic act whose object is a property right.[30] This would also include, for example, releasing someone from an obligation owed to the debtor.[31]

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[26] Section 15 of the Bankruptcy Act (No.10) 2559 (2016).
[27] Faculty of Law, Thammasat University (Prof. Sahaton Ratthanapaijitr et. al.) (n 21) 11.
[28] Sanunkorn Sotthipan, *Explanation of the Law of Obligations (Results of Obligations)* (5th edn, Winyuchon Publication House 2020) 384 (Thai language).
[29] For a discussion between the different options, see ibid 396–9.
[30] ibid 389.

(2) Second, harm must be caused to creditors. The concept of harm is not defined in Section 237 of the CCC. However, academics have expressed the concept in very consistent terms: a situation in which the juristic act of the debtor results in the assets of the debtor being reduced to a level at which they are insufficient to be used for the repayment of her creditors will be one in which harm is caused to creditors.[32]

(3) Third, the debtor must know that the creditor will suffer a loss. The debtor need not have the intention to cause the creditor to suffer a loss; it will be sufficient for the debtor to know that by doing the relevant juristic act it may result in the creditor suffering a loss due to the debtor having insufficient funds to repay.[33] If the debtor has sufficient assets to repay creditors at the time of the juristic act, it cannot be successfully challenged.[34] However, where a debtor transfers property to a relative, for example, but has genuine hope that she will be able to repay her creditors when their calls come, this will still satisfy the mental element since she was aware, at the time of the transaction, that it might result in a loss to her creditors.[35]

(4) Fourth, if the juristic act was not performed gratuitously, the counterparty or the third party who received the property must also have known at the time that the creditor would suffer a loss.[36] Here, the creditor must prove that the counterparty knew that the creditor would suffer a loss as a result of the juristic act.[37] It has been suggested by some commentators that the counterparty must know that the debtor is in debt specifically to the claimant; also, where she is aware that the debtor has creditors, she must also be aware that the debtor lacks sufficient property to repay them; otherwise, the counterparty will be found to be honest and the creditor's claim

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[31] Pricha Panichuang, Explanation of Bankruptcy Law, the Law on the Bankruptcy Court and Procedure in Bankruptcy Cases, and the Law on Debtor Recovery (1st edn, Nitibannagarn 2002) 250 (Thai language).
[32] E.g. Seni Pramoj, *The Civil and Commercial Code on Juristic Acts and Debt*, vol 2 (Thaiwattanapanich 1962) 2:718 (Thai language); Jit Setthabutr, *Principles of Debt in Civil Law* (20th edn, Thammasat University 2011) 111 (Thai language); Sophon Ratanakorn, *Explanation of Law on the Principles of Debt* (10th edn, Nitibannagarn 2010) 302 (Thai language).
[33] Pramoj (n 32) 2:712; Serim Winitchaigul, *Explanation of the Principles of Juristic Acts and Debt in the Civil and Commerical Code* (Excise Department Publishing 1972) 210 (Thai language); Ratanakorn (n 32) 309.
[34] Sotthipan (n 28) 389.
[35] Pramoj (n 32) 2:714-5.
[36] Sotthipan (n 28) 389.
[37] Ratanakorn (n 32) 310.

will fail.[38] Certainly, if the counterparty is unfamiliar with the debtor and merely obtains a favourable price for assets, the creditor's claim will be unsuccessful.[39]

The counterparty's knowledge may be inferred from other facts which the counterparty knew or should have known, or from actions taken by the counterparty.[40] So, for example, if the debtor sells assets at a particularly low value or to a person closely connected with the debtor, such as a relative or a person who frequently does business with the debtor, then knowledge of the counterparty may be inferred.[41]

The subsequent sections, 238 to 240, add qualifications and detail to the operation of Section 237. Section 238 provides that cancellation of a juristic act under Section 237 must not affect the rights of honest third parties (i.e. subsequent transferees) who paid value before the action commenced. Section 239 provides that cancellation operates in favour of all creditors and Section 240 sets limitation periods: a claim must be brought within one year of the time at which the creditor knew of the juristic act, and within 10 years of the performance of the juristic act.

3.3.3 Insolvency office holder's power to challenge transactions

The BA also gives powers to an insolvency office holder to challenge fraudulent transactions, which are enhanced in certain circumstances. In the case of insolvent liquidation,[42] Section 113 of the BA allows the insolvency office holder to apply to court for cancellation of a fraudulent transaction using the right under Sections 237-240 of the CCC.[43] However, Section 114 of the BA enhances the ability of the insolvency office holder to bring a claim in three circumstances. Where the juristic act (i) arose within a year of the petition for bankruptcy, (ii) was a gratuitous act, or (iii) was an act for which the debtor received unreasonably small

[38] E.g. Pairot Wayuphap, *Explanation of Debt in the Civil and Commercial Code* (12th edn, Office of Legal Education Training of the Thai Bar Association 2018) 340 (Thai language).
[39] Pramoj (n 32) 2:723.
[40] Ratanakorn (n 32) 310.
[41] Pramoj (n 32) 2:723; Ratanakorn (n 32) 310.
[42] See Section 90/40 of the BA in relation to business reorganisation. The rights in respect of business reorganisation mirror those in relation to insolvent liquidation, and will therefore not be separately discussed here for brevity.
[43] Wicha Mahakhun, *Explanation of the Law of Bankruptcy and Debt Reorganisation* (15th edn, Nitibannagarn 2016) 262 (Thai language).

remuneration, it will *prima facie* be presumed to satisfy the mental element required by Section 237.

In these situations, it will be for the defendant to overturn the presumptions: for example, where there was a transaction in return for value, she must prove either that the debtor did not know that the juristic act would prejudice the creditors or that the counterparty was unaware of the facts which would make the juristic act prejudicial to creditors.[44] Similarly to challenges brought by creditors, honest further transferees who gave value will be protected through Section 238 from challenges brought by an insolvency office holder under Sections 113 and 114.[45] Honest, here, means not knowing that the debtor was factually insolvent. Regarding application of the limitation period under Section 240 of the CCC, there are two lines of Supreme Court cases: in earlier decisions, the period is calculated from the date of knowledge of the insolvency office holder; in later decisions, from the date of knowledge of the relevant creditor.[46]

3.3.4 Challenging preferential transactions

Under Section 115 of the BA, the insolvency office holder may challenge a transfer of property or any act done by the debtor, or with the debtor's consent, in the period of three months before the bankruptcy petition, where the act was done with the intention of enabling a creditor to have advantage over the others. The provision applies broadly, covering not just transfers of property but also any 'act', including anything which has the effect of reducing the value of the assets of the debtor company. An example would be granting a mortgage to a creditor who was previously unsecured. Similarly to the right to challenge fraudulent transactions, a successful challenge will result in the cancellation of the act to return the parties to the previous position.[47]

Paragraph 2 extends the three-month period to one year in the case of advantage being given to the debtor company's insiders. 'Insider' is defined under

[44] Panichuang (n 31) 228.
[45] Faculty of Law, Thammasat University (Prof. Sahaton Ratthanapaijitr et. al.) (n 21) 278–9.
[46] Former view: Supreme Court Decision 1752/2518; latter view: Supreme Court Decisions 209/2521, 3923/2539, 6514/2550 and 19883/2555. See ibid 279.
[47] Auen Kunkeaw, *Bankruptcy Law* (13th edn, Krungsiam Publishing Co, Ltd 2016) 262–4 (Thai language).

Section 6 of the BA to include, in the case of a debtor which is a limited company, directors, managers, auditors, and shareholders with over a 5% shareholding, as well as various enterprises in which they are significantly involved. Under Section 116, such challenges must not prejudice the rights of third parties acquired in good faith and for value.

3.4 Challenging transactions in English law

Although English law has a wide variety of grounds on which an act may be avoided when a debtor company enters a formal insolvency proceeding,[48] the most important in-scope actions are the creditors' (or insolvency office holder's) power to challenge fraudulent transactions under Section 423 of the IA86, and the insolvency office holder's power to challenge transactions at an undervalue and preferential transactions under Sections 238 and 239 respectively. The action under Section 423 is available at any time, while the insolvency office holder's rights may only be used retrospectively when the debtor company is in formal insolvency proceedings. After a brief summary of the development of these actions, which have a long history in English law, the features of each will be discussed in turn.

3.4.1 Historical background and developments

All three actions – under Sections 423, 238 and 239 – trace their origins back to the sixteenth century Statute of Elizabeth. This statute made void any 'gifts, grants, alienations [or] conveyances' which had been made intending to 'delay, hinder, or defraud creditors and others,'[49] subject to a defence for those who had entered into a transaction *bona fides* and for valuable consideration.[50] Soon after enactment, this mental element included constructive fraud, where the relevant intention could be inferred from the circumstances, as well as actual fraud. Over time, so-called 'badges of fraud' were developed by the courts that could be used to infer

[48] For example, Goode enumerates a list of nine separate common law and statutory grounds: see Goode (n 4) 529.
[49] Statute of Elizabeth, Sections I–II.
[50] Ibid, Section VI.

fraud on the part of the debtor.[51] Although the core of the Statute of Elizabeth is combatting fraud, its ambit is wider: not merely deceptive actions, but any action with the intent and purpose of prejudicing the ability of creditors to enforce their claims.[52] However, the focus appears to have been on the intention of the debtor: transfers for no value or at extreme undervalue were considered 'badges of fraud,' but the courts were generally unwilling to engage in scrutinising whether *adequate* value was given.[53]

This statutory procedure endured for almost four centuries, being replaced by Section 172 of the Law of Property Act 1925, the wording of which differed from its predecessor causing certain issues.[54] The wide-ranging and hugely influential Insolvency Law Review Committee Report of 1982 ("Cork Report") approved fraudulent conveyance law in principle but recommended clarifying this section to remove uncertainties.[55] Ultimately Section 423 of the IA86 replaced the previous law relating to fraudulent transactions, amending the position as follows. First, only transactions at an undervalue may be challenged: intent to defraud alone is insufficient. Secondly, the counterparty's state of mind is no longer relevant.

Section 238 is also descended from the Statute of Elizabeth, but by a more indirect route.[56] Following the Statute of Elizabeth, the Bankruptcy Act 1603 included a right for the insolvency office holder to challenge transactions made not in good faith and not for value in the period before bankruptcy, and similar provisions survived in successive Acts, including the 1883 and 1914 Bankruptcy Acts mentioned above. However, all of these Acts only applied to the bankruptcy of individuals. In the case of corporate debtors, transactions were usually challenged on the basis that they were *ultra vires* the company or an abuse of directors' powers.[57] The Cork Report ultimately suggested applying the same regime to undervalue transactions to corporate debtors as to individuals, which resulted in Section 238 of the IA86. However, some

[51] John Armour, 'Transactions Defrauding Creditors' in John Armour and Howard Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Bloomsbury Publishing 2003) 96.
[52] Clark (n 2).
[53] Armour (n 2) 39.
[54] Armour (n 51) 97.
[55] Kenneth Cork, 'Report of the Review Committee on Insolvency Law and Practice' (1982) Cmnd 8558 paras 1200–20.
[56] Armour (n 2) 39–41.
[57] Cork (n 55) para 1237. These are discussed in Chapter 4.

of the features of Section 238 are rather different to earlier legislation and appear to go beyond the prevention of fraud due to their objective, rather than subjective, focus. This has led some commentators to view the purpose of Section 238 in a different light: as intending to address the perverse incentives of the management of the debtor in the period prior to insolvency.[58] This is discussed further below.

Finally, Section 239 also traces its origins to the Statute of Elizabeth, with the courts in the 16th century developing the principles of the legislation to address preferential conveyances in bankruptcy, per Lord Coke in the 'Case of the Bankrupts' decided in 1584.[59] The courts extended the reach of the remedy to the period before bankruptcy in the 18th century, a move generally attributed to Lord Mansfield who viewed preferences as a deliberate attempt to skew the rules of distributions in bankruptcies, thereby amounting to fraud on the statutory scheme.[60] A notable distinction was drawn between voluntarily giving a preference to creditors and paying creditors who demanded their payment by threatening legal action, which was considered acceptable as part of the ordinary course of business.[61] The case law found statutory recognition in the Bankruptcy Act 1869, and survived through later bankruptcy Acts, including 1883 and 1914 mentioned above, and twentieth century companies Acts which tracked the same wording. The Cork Report acknowledged the difficulty of proving the mental element of the debtor with regard to preferences but preferred to retain it, albeit with a presumption in the case of connected persons.[62]

Overall, the historical development of English law relating to challenging transactions emphasises the focus on the state of mind of the debtor, with the origins of the actions rooted in moral culpability. However, interestingly there has been movement away from this in respect of transactions at an undervalue which, as demonstrated below, includes a notably objective test for whether transactions may be successfully challenged.

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[58] Armour (n 2).
[59] (1584) 76 ER 441. See also Adrian Walters (n 11) 127.
[60] See discussion in ibid 127–8. Indeed a similar extension was made at the same time to fraudulent conveyances.
[61] E.g. Rust v Cooper (1777) 2 Cowp 629; ibid 128–9.
[62] Cork (n 55) para 1256.

3.4.2 Creditors' power to challenge transactions

Where a company enters into a transaction at an undervalue for the purpose of putting assets beyond the reach of a creditor, or for the purpose of otherwise prejudicing the interests of a creditor, an action may be brought under Section 423 of the IA86. In respect of companies, the concept of transaction at an undervalue is the same as in respect of the action under Section 238 discussed at 3.4.3 below. Unlike the action in respect of transactions at an undervalue, however, it is not necessary that the company be in a formal insolvency process to start the action, nor is there any statutory time limit in respect of which transactions may be challenged, although the usual limitation periods apply.

The mental element for this action is not a specifically dishonest motive, and whether the parties acted on legal advice is not relevant: it is sufficient if the company's subjective purpose was to put the assets beyond the reach of its creditors, or of a particular creditor.[63] However, it must be the *purpose*, not merely the *result* of the transaction.[64] A transaction entered into for a tax advantage but which also had the result, as a by-product, of putting assets out of reach of creditors, for example, would not suffice for the mental element.[65]

Application for an order can be made to the court by an insolvency office holder or, with leave of the court, by a victim of the transaction, which includes not only creditors but anyone who suffers actual or potential prejudice.[66] The orders that may be made by the court are set out in Section 425, and essentially correspond with those relating to transactions at an undervalue discussed at 3.4.3 below, with the same protection for *bona fide* third parties as under Section 241(2), also discussed below.

3.4.3 Insolvency office holder's power to challenge transactions

Under Section 238 of the IA86, any transaction entered into in a two-year period prior to formal insolvency proceedings under which the debtor

[63] Arbuthnot Leasing International Ltd v Havelet Leasing Ltd (No. 2) [1990] BCC 636. See also Goode (n 4) 623.
[64] Random House UK v Allason [2008] EWHC 2854
[65] Pinewood Joinery v Starelm Properties Ltd [1994] BCC 569
[66] Section 424 IA86; *Hill v Spread Trustee Co Ltd* [2007] 1 WLR 2404

company transfers significant net asset value to another party is vulnerable to challenge by the insolvency office holder. The key elements of the action are as follows:

(1) The action may only be brought by an insolvency office holder.[67]

(2) The transaction must have occurred at the 'relevant time', which has both a temporal element and a financial element. The temporal element is that the company must have entered into the transaction in the two-year period ending with the bringing of a successful petition for liquidation or administration. The financial element is that the company must have been unable to pay its debts at the time of the transaction, or became so as a result of the transaction. Here, the concept of 'unable to pay its debts' is defined in Section 123 of the IA86, and essentially includes being either cash-flow insolvent, i.e. being unable to pay its debts as they fall due or unable to satisfy a demand to pay a specific sum, or balance-sheet insolvent, i.e. having liabilities greater than its assets. Both the temporal and the financial element must be satisfied to bring a successful claim.

(3) The company must have entered into a transaction at an undervalue with a counterparty. The concept of transaction here is interpreted broadly, including not only contracts but also gifts and other arrangements which are not based on contract, and it may also extend to linked transactions even involving a different party and even court-ordered transfers.[68] The company must be a party to at least some part of the transaction.[69] The transaction must have been at an undervalue, measured from the insolvent company's point of view: i.e. value leaving the company must have been significantly more than that received by the company.[70] In principle, the value of an asset is the amount that a reasonably well-informed purchaser is prepared, in arm's-length negotiations, to pay for it.[71] Where there is a market for the asset, market value, established by expert evidence, will be considered the asset's

[67] Section 238(1)
[68] See discussion in Goode (n 4) 534.
[69] ibid 534–5.
[70] Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (2nd edn, Cambridge University Press 2009) 575.
[71] Phillips v Brewin Dolphin Bell Lawrie Ltd [2001] UKHL 2 per Lord Scott [30]

value.[72] It seems that any difference of more than 15% of the true value will be considered to be 'significant.'[73]

(4) Crucially, there is no need to prove a mental element on the part of the debtor or a counterparty to succeed in challenging a transaction at an undervalue. However, there are important statutory defences, including the 'bona fide business purpose' defence: under Section 238(5), the court may refuse to make an order under Section 238 if it is satisfied that the company entered into the transaction in good faith and for the purpose of carrying out its business, and at the time that it did so there were reasonable grounds for believing that the transaction would benefit the company. Thus, there are both subjective and objective elements to this defence. The subjective good faith element refers only to the company, not the counterparty, linking to the historical origins of the action, and this is considered satisfied if those involved on behalf of the company genuinely thought that the transaction would promote its interests. However, importantly, the test remains ultimately an objective one since an objective element to the defence must also be established to protect the transaction against challenge.

An additional statutory defence is offered by Section 241(2) IA86 in favour of transferees and recipients of the benefit otherwise than from the company (i.e. not direct counterparties) in good faith, for value, and without notice. Parties connected with the company or the counterparty are presumed not to act in good faith.[74]

The court has wide powers in respect of remedies. Under Section 238(3) of the IA86, the court is required to make such order as it thinks fit for restoring the position to what it would have been if the company had not entered into the transaction. There is a list of specific actions the court may take, set out in Section 241, which includes ordering a return of the transferred property, the proceeds of sale, or an amount of money to the company. Notably, there is no power for the court to set aside or invalidate the transaction: the transaction remains valid, but the court has the power to reverse its adverse effects.[75] Indeed, where restoration of the previous

[72] *Re Brabon, Treharne v Brabon* [2001] BCLC 11; see discussion in Goode (n 4) 541–2.
[73] National Westminster Bank plc v Jones [2002] 1 BCLC 55.
[74] Section 241(2A) IA86.
[75] Goode (n 4) 558.

position is impossible, for example because of the imposition of the rights of innocent third parties, the court may make an order which restores the original position *so far as possible*.[76] So, for example, where property has been sold by the counterparty to a third party, the court may instead order the restoration of the proceeds of sale from the counterparty to the debtor company, or property purchased with such proceeds.[77]

3.4.4 Challenging preferential transactions

Under Section 239 of the IA86, where a company gives an advantage to a creditor in the period of six months or, in the case of connected persons, in the period of two years before entry into formal insolvency proceedings, the transaction is subject to challenge by the insolvency office holder. The key elements of the action are as follows:

(1) There must be a factual preference: where a company does anything, or suffers anything to be done, that has the effect of putting one of its creditors in a better position in insolvent liquidation than it otherwise would have been in.[78] This also applies to sureties and guarantors of the company's liabilities.[79] However, it should be noted that a factual preference will only be one which disturbs the order of payments on insolvent liquidation; therefore a payment to a secured creditor will not generally be considered a preference, up to the value of the creditor's security.[80]

(2) The company must have been influenced by a desire to improve the position of the creditor, surety or guarantor.[81] Specifically, this is a desire to do something which has the effect of putting one of its creditors in a better position in insolvent liquidation. 'Desire' here appears to be interpreted as a subjective positive wish to achieve the result, which was at least one of the factors which influenced the decision.[82] Where the company gives a factual preference to a connected person,

[76] Armour (n 2) 83.
[77] Section 241(1)(b) IA86.
[78] Section 239(4)(b) IA86.
[79] Section 239(4)(a) IA86.
[80] Goode (n 4) 584.
[81] Section 239(5) IA86.
[82] *Re MC Bacon Ltd* [1990] BCC 78 at 87-88.

which includes directors, shadow directors and associates,[83] there is a rebuttable presumption that the company was influenced by the relevant desire.[84]

(3) The factual preference must have been given at the relevant time, which, similarly to Section 238 discussed above, has a temporal and financial element. The temporal element is the period of six months before the entry into formal insolvency proceedings. This is extended to two years in the case of a transaction to a person connected with the company. The financial element is the same as discussed above in relation to transactions at an undervalue, although there is no presumption of factual insolvency in the case of preferential transactions with connected persons.

The court has the same powers in respect of remedies, with the same protections for third parties acquiring a benefit as a result of a preference in good faith, for value, without notice as in respect of transactions as an undervalue discussed above.[85]

3.5 Challenging transactions in German law

German law relating to challenging transactions is found in the *Anfechtungsgesetz* ("AnfG")[86] or the Avoidance Act, in relation to challenges brought by creditors outside of bankruptcy, and in the German Insolvency Code ("InsO"),[87] in relation to challenges brought by the insolvency office holder. Employing the same categorisation used for Thai and English law above, which as discussed is not clearly represented in many civil law jurisdictions including Germany, so-called fraudulent transactions are addressed by Sections 3 (wilful disadvantage) and 4 (gratuitous benefit) of the AnfG in relation to creditors, and Sections 132 (transactions directly disadvantaging creditors), 133 (wilful disadvantage) and 134 (gratuitous benefit) of the InsO in relation to the insolvency office holder. Preferential transactions are addressed by Sections 3(2) AnfG and 133(2) InsO (wilful disadvantage), 130

[83] Section 249 IA86. Associate is defined in Section 435 IA86.
[84] Section 239(6) IA86.
[85] Section 239(3) IA86 gives the court the power to make orders in respect of preferences. The provisions of Section 241 apply to both transactions at an undervalue and preferences.
[86] Gesetz über die Anfechtung von Rechtshandlungen des Schuldners außerhalb des Insolvenzverfahrens (Anfechtungsgesetz, AnfG), BGBl, 1994, Part I, 2911.
[87] *Insolvenzordnung* [Insolvency Act], v. 5.10.1994 (BGBI. I S.2866).

(congruent coverage) and 131 (incongruent coverage), as well as 135 (equity substituting shareholder loans) of the InsO. After a brief summary of the development of the law, the features of each will be discussed in turn.

3.5.1 Historical background and developments

A bankruptcy system was first adopted in Germany in the sixteenth century: in the centuries prior to this, a failure to pay one's creditors was considered the realm of criminal law, with prison, torture and slavery as options for the debtor at various times under the developing Germanic common law.[88] At around the end of the fifteenth to the start of the sixteenth century, the Roman system of *cessio bonorum* was incorporated into German law in a reform of criminal law.[89] However, the story of modern bankruptcy and avoidance law, building on this notably Roman origin, begins in 1877 with the *Konkursordnung* of that year.[90] This piece of legislation was in force, at least in the western part of modern-day Germany, continuously until the InsO became law on 1 January 1999. The InsO took a long time to arrive into force: its drafting commission was established in the 1970s but, due in part to reunification, the final draft was not passed until 1994, and, for political and financial reasons, Parliament decided that it would not enter into force until 1999.[91] As a result of its lengthy legislative process, much discussion was made over the inclusion and review of ideas from other jurisdictions, including the United States, France, Japan, Austria and others.[92]

However, in spite of the broad-sweeping nature of the InsO reforms, in the area of challenging transactions the conceptual framework remains essentially the same as the *Konkursordnung*. This Act, which bears the hallmarks of the *actio pauliana* discussed above, has the same structure and methods of challenge as the InsO; the major differences are the extension of the periods for challenge, and the

[88] Karl Gratzer, 'Default and Imprisonment for Debt in Sweden: From the Lost Chances of a Ruined Life to the Lost Capital of a Bankrupt Company' in Karl Gratzer and Dieter Stiefel, *History of insolvency and bankruptcy: From an international perspective* (Södertörns högskola 2008) 21–3.
[89] Hermann Conrad, Deutsche Rechtsgeschichte/2 Neuzeit Bis 1806 (C F Müller 1966).
[90] [Bankruptcy Act] v. 10.2.1877 (RGBI S.351).
[91] Christoph G Paulus, 'The New German Insolvency Code' (1998) 33 Texas International Law Journal 141, 141–2.
[92] ibid 142.

subjective requirements, which have been somewhat reduced.[93] A recent amendment in 2017 altered the position in relation to challenging preferential transactions as acts which wilfully cause a detriment to creditors, improving the position of preferred creditors as discussed below. Challenging prejudicial transactions outside of bankruptcy has, since 1879, been covered by the AnfG. This Act reproduces relevant provisions of challenging transactions in bankruptcy legislation, including updates, and therefore can be seen to have the same historical background.

Overall, the regime relating to challenging transactions in German law remains conceptually the same as it was in the late 19th century, with its roots in the Roman law *actio pauliana*. Although the 1999 reforms extended the periods for challenge and removed some subjective elements, the recent 2017 amendments have, in the area of preferences, improved the position for preferred creditors. The detail of the provisions will now be discussed.

3.5.2 Creditors' power to challenge transactions

The right for creditors to bring an action to challenge prejudicial transactions outside of insolvency is contained in the AnfG. Section 3 of the AnfG provides that any legal act occurring in the previous 10 years may be challenged by a creditor if the debtor had the intention to prejudice her creditors, the counterparty knew of the debtor's intention to prejudice creditors at the time of the act, and the act prejudiced creditors. The elements which must be proved for a creditor to bring a successful claim are that there was a legal act which produced detriment to the creditor, and the presence of the required mental element with regard to both debtor and counterparty. These elements will now be discussed in more detail:

(1) In relation to the legal act, this concept should be understood broadly, encompassing not just transactions or juristic acts, but as any act of will that produces legal consequences.[94] Regarding detriment to creditors, where a company transfers assets to a counterparty and receives less than the fair value of the assets in return, the creditors will be considered to suffer a direct detriment (*unmittelbarer*

[93] ibid 147.
[94] In German, Rechtshandlung. See Thomas Bachner, Creditor Protection in Private Companies: Anglo-German Perspectives for a European Legal Discourse (Cambridge University Press 2009) 57.

Nachteil). However, German law also has a concept of indirect detriment (*mittelbarer Nachteil*), construed as any detriment to the creditors which arises after the legal act but beyond the consequences of the legal act itself. An example would be where a debtor sells assets for full and fair value, but subsequently dissipates the proceeds, so that the creditors are left with nothing, or uses the proceeds to flee the country.[95] A legal act causing an indirect detriment will suffice for this element.

(2) Regarding the second element, German law, like Thai law, requires a mental element on the part of both the debtor and the counterparty. The debtor must be shown to have at least '*bedingter Vorsatz*',[96] literally 'conditional intent', which is something less than direct intent.[97] The debtor must both foresee the risk to creditors and positively accept harming creditors as the likely consequence of the act.[98] The debtor must approve both the act and the detriment created for creditors.[99] For example, the High Federal Court, has held that the debtor must not only be aware that disadvantage to creditors is possible but also accept this risk by not allowing it to prevent her from taking such actions.[100] However, merely hoping that the debtor's economic situation will improve in the future will not suffice to show that the debtor did not intend to harm creditors, unless the debtor genuinely believed that she would be able to repay creditors supported by, for example, the certain expectation to receive credit to allow her to pay off her debts.[101]

A mental element must also be satisfied in relation to the counterparty. Section 3 of the AnfG requires knowledge on the part of the counterparty of the intent of the debtor to prejudice its creditors.[102] This is an element which presents a significant hurdle to a claimant, since it requires proving knowledge of one party about the intent of another party. However, there is a presumption of

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[95] ibid 62.
[96] BGH 27 May 2003, BGHZ 155, 75.
[97] Basil S Markesinis and Hannes Unberath, *The German Law of Torts: A Comparative Treatise* (4th edn, Bloomsbury Publishing 2002) 83–4.
[98] Gerhard Wagner, 'Distributions to Shareholders and Fraudulent Transfer Law' (2006) 7 European Business Organization Law Review 217, 220; Bachner (n 94) 69. See also BGH 18 April 1991, NJW 1991, 2144 at 2145; BGH 2 April 1998, ZIP 1998, 830 at 835.
[99] Wagner (n 98) 220.
[100] BGH 27 May 2003, BGHZ 155, 75.
[101] See discussion of relevant court judgments in Bachner (n 94) 70.
[102] ibid 77.

knowledge in the case that the counterparty is shown to know that the debtor was under the threat of insolvency and the act was prejudicial to creditors.[103]

Moreover, under Section 4 of the AnfG, no mental element, either of the debtor or the counterparty, is required in respect of gratuitous acts, which may be challenged if they took place in the preceding four years and caused a detriment to creditors. In addition, in relation to connected persons, defined in Section 138 InsO, acts causing direct detriment taking place in the two years before the avoidance action are contestable unless the counterparty can show that she did not know of the debtor's intention to disadvantage creditors.

The result of a successful challenge under the AnfG is that the asset must be made available to the creditor to the extent of her claim.[104] The provisions of the BGB on unjust enrichment in the case of the recipient knowing of the defect in legal basis apply, including relevant protections for third parties.[105]

3.5.3 Insolvency office holder's power to challenge transactions

In a case where the debtor enters formal insolvency proceedings, the insolvency office holder has standing to challenge transactions. Sections 132 and 133 InsO cover acts which are directly detrimental to creditors and wilfully harmful acts respectively, whereas Section 134 concerns gratuitous benefits.

Section 133 is nearly identical to Section 3 of the AnfG, except that the insolvency office holder has the power to bring the claim and the time limitation is 10 years prior to the request to open insolvency proceedings. Therefore, the analysis of Section 133 of the InsO follows the analysis of Section 3 of the AnfG above.

Under Section 132 of the InsO, a transaction causing a direct detriment to creditors may be challenged which occurred during the three months before an insolvency petition, if the debtor was unable to pay its debts on the date of the transaction and if the counterparty knew this. Knowledge of the debtor's inability to pay its debts is deemed to be established by the counterparty's knowledge of circumstances which 'compellingly bespeak' the debtor's insolvency.[106] However,

[103] Section 3(1) AnfG.
[104] Section 11 AnfG.
[105] Section 819 BGB.
[106] Bachner (n 94) 83–4.

further assistance will be given to an insolvency office holder in situations involving connected persons, defined in Section 138 of the InsO. In relation to Section 132, persons with close connections to a company, including for example companies with common directors or common owners, will be presumed to have been aware of the debtor's cash-flow insolvency. In relation to Section 133, where there is a transaction between the debtor and a counterparty who is a connected person in the two years before the opening of insolvency proceedings, the burden of proof regarding the subjective mental element will be reversed, as discussed above in relation to the AnfG.

Under Section 134 of the InsO, a gratuitous benefit given by the debtor may be challenged. Gratuitous here means that the recipient is not entitled to receive any payment or other consideration from the debtor, but nevertheless receives something. If the gratuitous benefit was given in the four-year period prior to formal insolvency proceedings, it may be challenged without any requirement to prove any particular mental state on the part of the debtor or the counterparty.

Section 145 of the InsO provides protection to third parties who were unaware of the circumstances giving rise to the power of the insolvency office holder to challenge the transaction. This does not apply in the case of gratuitous transfers, and there is a presumption of awareness in the case of connected persons.

3.5.4 Challenging preferential transactions

As discussed above, German law does not have a clear separation between the concept of fraudulent transactions and preferential transactions as in English and Thai law. Consequently, both Section 3(2) of the AnfG and Section 133(2) InsO discussed above include, in the concept of acts with which the debtor wilfully disadvantages creditors, the satisfaction of or grant of security for a debt. However, in this situation there are some important differences that were created by an amendment in 2017. The time period for the act is reduced from 10 years to 4 and, rather than knowledge of impending insolvency, the preferred creditor must have known of actual insolvency. Finally, if the preferred creditor has made a payment agreement or granted a payment facility, there is a statutory presumption that the creditor was not aware of insolvency at the time of the act. The effect of these

amendments is to put creditors in a stronger position, particularly suppliers, for example, who may benefit from the new presumption which will put an additional burden on the insolvency office holder when bringing a challenge.

Sections 130 and 131 grant the insolvency office holder the power to challenge preferential transactions occurring prior to formal insolvency, dealing, respectively, with situations of 'congruent coverage' and 'incongruent coverage'. Congruent coverage concerns a situation where a creditor is paid or receives security in relation to an amount owed, but in each case the value of the repayment or security matches that which was agreed between the parties. Incongruent coverage, by contrast, is where a creditor receives payment or security in a greater amount, earlier, or in a manner that is otherwise inconsistent with the original agreement.

A transaction may be challenged under Section 130, congruent coverage, where the following elements are satisfied:

(1) a transaction occurs in the three-month period prior to the filing of an insolvency petition which grants security to the creditor or otherwise provides for the creditor to be satisfied or repaid;

(2) the value of the security or repayment and the manner of performance of the debtor matches what was originally agreed between the parties; and

(3) at the time of the transaction, the debtor was unable to pay its debts and if the counterparty knew this, similarly to Section 132 above. In the case of connected parties, pursuant to Section 138, the knowledge of the counterparty is presumed.

A transaction may be challenged under Section 131, incongruent coverage, similarly to Section 130, but with certain important differences. First, in the case of incongruent coverage in the one-month period prior to an insolvency petition, there is no requirement to prove illiquidity of the debtor nor any knowledge of the counterparty.[107] During the remainder of the three-month period prior to insolvency, there is a requirement to prove that the debtor was illiquid on the date of the transaction and that the counterparty knew that the transaction would be detrimental

[107] Section 131(1) InsO.

to other creditors.[108] Awareness of the counterparty of circumstances that would lead to this conclusion is sufficient.[109] Again, in the case of connected parties, pursuant to Section 138, the knowledge of the counterparty is presumed.[110]

Section 135, additionally, sets out a specific power to challenge transactions which grant security for or repay a loan from a shareholder. A transaction granting security is contestable if occurring within the 10-year period prior to formal insolvency proceedings, while repayment of a shareholder loan is contestable if it occurs within the one-year period prior to formal insolvency proceedings.[111] During this one-year period, the insolvency office holder can also challenge repayments of loans to third parties if a shareholder was a guarantor or gave security for the repayment of the loan.[112] There is no requirement to prove any mental state of any of the parties.

3.6 Comparative analysis and evaluation

This section compares the three jurisdictions' approaches to creditor protection by way of challenging transactions in light of the analysis of each jurisdiction above. This section, after a comparison of the historical development, compares the rules relating to the creditors' power to challenge transactions, the insolvency office holder's power to challenge transactions, and the right to challenge preferential transactions respectively. The final part of this section evaluates the approach of Thai law against the principles of creditor protection based on an ESV approach to corporate governance as discussed in Chapter 1.

3.6.1 Comparative Analysis

The review of the historical development of the rules relating to challenging transactions in the three jurisdictions reveals notably different paths. On one hand, English law traces its origins to the 16th century Statute of Elizabeth, with its focus on the prevention of fraud, and hence represents a legal regime concentrating

[108] ibid.
[109] Section 131(2) InsO.
[110] ibid.
[111] Section 135(1) InsO.
[112] Section 135(2) InsO.

on the mental state of the debtor alone. On the other hand, German law traces its origins to the Roman law *actio pauliana*, with its focus on balancing interests between the creditor-debtor and debtor-counterparty relationships. In its evolution from this concept, collusion between debtor and counterparty has been of the essence of the right to challenge; the mental state of the counterparty is highly relevant. Modern Thai law, by contrast, shifted in its adoption of the two models during the early 20th century: the English bankruptcy model was replaced by the Roman-law-inspired model through Section 113 of the BA. Later amendments to Thai law confirmed this link, in particular the revision of Section 114 discussed above. Interestingly, the right to challenge transactions in Thai law always applied to limited companies; this was not the case in English law until revisions in the 1980s following suggestions of the Cork Report.

More recent developments in Thai law have reduced general 'twilight periods' (i.e., the period of time in which a transaction takes place prior to bankruptcy which makes it susceptible to challenge) but extended them in the specific case of parties connected with the company, recognising the special risks of the debtor company engaging in harmful transactions in such circumstances. Notable developments in English law, by contrast, have included a reduction in emphasis on establishing the required mental element of the debtor, to the point of adopting a purely objective test in the case of Section 238 as discussed above. German law, by contrast, has remained substantially similar to its 19th century form; changes have been to extend twilight periods and, in some circumstances, such as involving connected parties, to reduce the focus on the mental element of the counterparty. However, neither Thai law nor German law has gone so far as to embrace an objective approach in this area, like English law. The current legal provisions will now be compared in detail.

3.6.1.1 Creditors' power to challenge transactions

A key difference in the approach of the three jurisdictions to the concept of the creditors' power to challenge transactions is the mental element that must be proved in relation to the counterparty to the transaction, in the case of non-gratuitous transactions. In Thai and German law, intention or knowledge that the

act or transaction would prejudice the creditor must be shown on the part of both the debtor and the counterparty. In English law, it need only be proved that the debtor acted for the purpose of putting assets beyond the reach of its creditors. This removes a significant evidential hurdle in respect of challenging a transaction in English law, compared to the other two jurisdictions: there is no requirement to prove any particular mental state of the counterparty. However, third parties who receive a benefit in good faith, for value, and without notice are protected.

Regarding Thai law, it should be noted that the mental element required to be proved on the part of the debtor is merely knowledge that the transaction would prejudice the creditor, which is probably a lower requirement than the English law requirement of 'for the purpose of'. However, this knowledge must be proved for both debtor and counterparty. The German requirement of 'conditional intent' of the debtor is stricter than the Thai requirement of knowledge that the transaction would prejudice the creditor, and it must also be proved that the counterparty knew of this intent.

3.6.1.2 Insolvency office holder's power to challenge transactions

In relation to the insolvency office holder's power to challenge transactions, there is a similar divergence between the three jurisdictions. Although all three increase the powers for insolvency office holders to challenge transactions occurring in the twilight period before formal insolvency proceedings, the extent of these powers differs. Thai law grants a presumption of the required mental element in a one-year twilight period, or in the case of a gratuitous transaction or one for unreasonably small value in return. However, this is only a presumption, and it can be overturned by the debtor.

In German law, the twilight period is shorter – only three months – and the insolvency office holder must prove that the debtor was unable to pay its debts and the counterparty knew this. However, in the case of connected persons, the twilight period extends to two years, and the burden of proof of the mental element is reversed. There is no extension of the twilight period in Thai law or increased presumption in the case of connected parties. Furthermore, although the general twilight period is shorter in Germany than the other jurisdictions, it should be

noted that companies may enter formal insolvency proceedings in Germany more swiftly than in either England or Thailand, as discussed in more detail in Chapter 4.

In English law, if there is a transaction at a significant undervalue in the two-year twilight period when, or as a result of which, the debtor is insolvent, the insolvency office holder may challenge the transaction without the requirement to prove any mental element on the part of debtor or counterparty. Indeed, in the case of connected parties, there is a presumption that the debtor was factually insolvent at the time of the transaction. Although there is a defence, it requires proving both that, subjectively, there was a good faith business purpose for the transaction and that, objectively, there were reasonable grounds for believing that the transaction would benefit the debtor company. As a result, undervalue transactions may be successfully challenged in English law on an entirely objective basis.

Finally, English law gives the court broad powers to restore the parties, as far as possible, to the position prior to the transaction, which also applies to preferential transactions discussed below. The concept is not of invalidating the transactions, but of a wide variety of restorative orders such as the return of on-sale proceeds received by counterparties. This variety of options is not available to the German or Thai courts.

3.6.1.4 Challenging preferential transactions

In relation to challenging preferential transactions, Thai law grants a three-month twilight period prior to insolvency; however, this is extended to one year in the case of the debtor company's insiders. The mental element is intention, on the part of the debtor, of enabling a creditor to have an advantage over others; no mental element need be proved in relation to the counterparty, reflecting the English law influence of this provision. In relation to English law, the twilight period is a longer six-month period, which may be extended to two years in the case of connected persons, although the company must be shown to have been factually insolvent at the time of, or due to, the transaction. The mental element in English law is a 'desire' to improve the position of the creditor: i.e. that a subjective positive wish to achieve the result was at least one of the factors influencing the decision. In the case of connected persons, the mental element is presumed.

In relation to German law, preferential transactions may be challenged using the same regime for challenging other transactions, albeit with reduced twilight periods. However, there are also specific provisions for challenging preferential transactions in relation to ‘congruent’ and ‘incongruent’ coverage. In the case of congruent coverage, the twilight period is three months, and the counterparty must have known that the debtor was unable to pay its debts, which is presumed in the case of connected parties. In relation to incongruent coverage, there is no requirement to prove illiquidity or knowledge of the counterparty in the one-month period prior to insolvency: therefore, in this short period, the fact of the preferential transaction is sufficient for challenge. In the remainder of the three-month twilight period, illiquidity and knowledge on the part of the counterparty that the transaction would prejudice creditors are required. Notably, there is no requirement to prove a mental state in respect of repayments of shareholder loans during a one-year twilight period.

Again, in relation to preferences, English law gives broader powers to an insolvency office holder than Thai law, due to the longer twilight periods; however, in Thai law, there is no requirement to show that the debtor was factually insolvent at the time of the preferential transaction. In relation to German law, the twilight periods are similar to Thai law, and in many cases there is a requirement to prove illiquidity of the debtor and knowledge of the counterparty, additional hurdles to succeeding with a claim. However, in the case of incongruent coverage one month before formal insolvency, or in the case of shareholder loans, there is no requirement to prove a mental element, unlike Thai law.

3.6.2 Evaluation of Thai law

As discussed above, from an ESV perspective of the corporate objective, rules allowing creditors to challenge prejudicial transactions are justified on the basis that where the creditors become the debtor company’s residual claimants, the company is required to act ultimately in their interests, albeit considering the interests of other stakeholders. A challenge results in reversing the effect of prejudicial transactions when the company was factually insolvent but had not yet entered into formal insolvency proceedings, if such transactions were not done to benefit creditors as a whole. Furthermore, in relation to non-adjusting creditors who

are at special risk of harm as discussed in Chapter 1, the ability to challenge preferential transactions is also crucial, as better informed, more powerful creditors may act opportunistically to increase their chances of being repaid from the assets of the failing company, prejudicing any potential recoveries of non-adjusting creditors.

Although similar at first glance, the approach of Thai law to this issue is in fact materially different to the comparator jurisdictions, in ways which potentially result in a worse position for non-adjusting creditors. Fundamentally, the Thai and German approaches to the issue of challenging transactions relies on proving the required mental element on behalf of both the debtor and the counterparty. English law has generally fewer requirements on proving mental elements, particularly of counterparties, and, in its most recent developments, has removed entirely the requirement to prove a mental element in relation to challenging undervalue transactions in the twilight period before insolvency. This objective approach has, as observed by commentators, a distinctively different purpose to the fraud-prevention of the law from which it derived.[113] In its potential for allowing claw-back from innocent counterparties, it serves instead to ameliorate the perverse incentives operating on debtors in financial difficulties. Where potential counterparties in the business environment are aware that undervalue transactions may be challenged on an objective basis, they are incentivised to either pay full market value for assets or conduct enquiries into the financial affairs of the company or both. Thus, an objective test recruits third parties in the business environment as monitors of value on behalf of creditors, ensuring that the debtor company's management does not engage in asset dilution.

By contrast, a subjective approach, as in Thai and German law, has the opposite effect: where a potential counterparty sees a good bargain, they are better protected by knowing nothing about the debtor company's circumstances. The focus of these systems is the protection of honest counterparties, rather than on the preservation of the assets of the company for the benefit of its creditors. This has the advantage of allowing companies in financial difficulties to sell their assets at a low price to keep trading; however, it also results in asset dilution, potentially harming, in particular, non-adjusting creditors.

[113] Armour (n 2) 56.

The comparative analysis might lead to a conclusion that the three jurisdictions lie on a spectrum as regards their approach to challenging transactions: English law at one end with, in the case of undervalue transactions, an objective test and long twilight periods, Thai law and German law at the other with a subjective focus and shorter twilight periods. Thai law would perhaps be viewed as closer to English law than German law since the mental requirements are arguably easier for a claimant to prove. However, this conclusion misses the point that, as discussed in Chapter 2, in Germany, transactions between a company and its shareholders or connected parties may be challenged through the rules relating to disguised distributions, equity substituting shareholder loans, or the special challenge for preferential transactions in relation to shareholder loans under Section 135 of the InsO. As a result, German law may address a transaction with a company's connected parties via these mechanisms, relying on objective criteria, which under Thai law could only be challenged on grounds which ultimately require the presence, even if it may be presumed, of a subjective mental element.

As a result, the comparative analysis performed here highlights the lack of an objective means of challenging transactions which result in asset dilution in Thai law. This invites a conclusion that Thai law ultimately focuses on the subjective intentions of the debtor and counterparties, promoting the protection of innocent third parties in the business environment. However, as a result, the incentives on company insiders to benefit themselves at the expense of non-adjusting creditors are not strongly addressed by this area of law. This conclusion results in potential improvements that could be made to align the law in this area more closely with the ESV model of corporate governance discussed in Chapter 1.

One option would be to create an objective test in relation to challenging transactions. As discussed above, English law, which influenced the BA, has in its latest phase of development adopted an objective approach to challenging transactions in the twilight period. German law has an objective approach in relation to preferential transactions in a one-month twilight period, as well as objectivity through the approaches based on legal capital and the doctrine of disguised distributions as discussed in Chapter 2: in other words, Germany also relies on an objective approach in many transactions with connected parties. On this basis, an

objective approach, which, as discussed, serves to address the perverse incentives operating on debtors in financial difficulties might be advocated.

A relatively conservative extension of Thai law, consistent with the ESV approach, would therefore be to amend Sections 114 and 115 of the BA to apply an objective test in the case of connected parties. Drawing on the experience of English law, a 15% difference in value in the case of a transaction with a connected party could be open to challenge. This could be subject to a defence that, objectively, there were reasonable grounds for thinking that the transaction would benefit the company: purely subjective considerations would not suffice to provide a defence. In relation to preferential transactions, in a short time-period before formal bankruptcy, repayments to connected parties could be made subject to challenge without the requirement to prove any mental element. These amendments would be justifiable from an ESV perspective, on the basis that such transactions benefit shareholders at a time when the company should be run for the benefit of creditors, the residual claimants. An objective test would have the benefit of recruiting others in the business environment as monitors of value, as compared to a subjective test which creates the incentive not to ask questions.

Furthermore, an additional connected improvement would be to permit the courts to make different orders, where appropriate, other than to cancel the transaction via Section 114 of the BA. Since the creditors in bankruptcy have no ability to claim against a specific asset but only its value following disposal, it is recommended that the court be permitted to make a variety of potential orders, including requiring the counterparty to contribute a sum equal to the difference between the amount paid and the market value to the debtor company. This would benefit creditors while causing less disruption to the business environment generally than always requiring the cancellation of the transaction, which may be prevented by the involvement of innocent third parties. The contribution should also cover the costs of valuation by the insolvency office holder, to prevent these from falling onto non-adjusting creditors. It should be noted adopting this suggestion would alter the generally accepted doctrinal concepts underlying the results of the cancellation;

however, these have been criticised by commentators.[114] It might also require de-coupling Section 114 of the BA from Section 237 of the CCC, as was previously the case as discussed above.

The drawback of this proposal is that it represents a fundamental change to Thai law's approach in this area, which has been to focus only on penalising unethical conduct through the presence of the legal tests' subjective elements, and to preserve flexibility for companies in financial difficulties. Therefore, it might be argued that, rather than a significant revision to this area of law to change it into a major method for protecting non-adjusting creditors, improvements might be better made to other areas of Thai law which address conduct harmful to non-adjusting creditors, particularly unethical conduct, as will be discussed in more detail in the next chapter.

3.7 Conclusion

This chapter has addressed this dissertation's two opening research questions, of whether non-adjusting creditors are sufficiently protected, and how the law relating to their protection has developed, in relation to challenging transactions. Initially, this chapter discussed the concept of challenging transactions within the context of creditor protection, such transactions categorised into so-called fraudulent transactions, which may be challenged either by creditors themselves or an insolvency office holder on their behalf, and preferential transactions. Challenging fraudulent, or undervalue, transactions aims to address asset dilution, while challenging preferential transactions specifically protects non-adjusting creditors against asset dilution by powerful preferred creditors. From an ESV perspective, the ability to challenge transactions occurring prior to formal insolvency is justified on the basis that the creditors are seen as residual claimants when a company is factually insolvent, and that the deterrent and remedial effects of the mechanisms act to preserve their interests prior to the protections of the formal insolvency regime.

With the comparative exercise, the historical discussion addressed the second research question, revealing how Thai law was initially influenced by English

[114] Sotthipan (n 28) 393–6.

law and its focus only on fraud prevention, and subsequently adopted a position derived from the Roman law *actio pauliana*, with its emphasis on addressing collusion between debtor and counterparty. Over time, Thai law has generally retained a focus on penalising only unethical conduct. By contrast, English law has moved towards objective tests, and German law has likewise adopted objectivity, albeit in part through applying different legal concepts drawn from legal capital to allow transactions to be challenged, as discussed in Chapter 2.

In relation to the first research question, the comparative analysis of current law reveals that Thai law, due to its retention of an ultimately subjective test, does not provide as strong protection for non-adjusting creditors as English or German law, given the latter's approach in the field of legal capital rules. Amendments could be made to introduce an objective approach which would, it is argued, be consistent with the ESV perspective. However, it can also be seen from the answer to the second research question that Thai law has retained an approach which focuses on penalising only unethical conduct, protecting innocent counterparties, and providing flexibility for companies in financial difficulties. Rather than revising this area of law to instil completely new principles, an alternative approach is to focus on areas of law which address conduct of directors. This is to where the next chapter of this dissertation turns.

CHAPTER 4
DIRECTORS' DUTIES AND OBLIGATIONS TO PRESERVE CREDITORS' INTERESTS

4.1 Introduction

This chapter examines the third category of rules which offer protection to non-adjusting creditors: the duties which the law confers on those making business and policy decisions concerning the company, and the sanctions for breach of those duties. Such duties can be split into two subcategories. First, the duties that directors owe at all times, or 'general duties', and second those that apply when a company encounters financial difficulties, or 'duties to preserve creditors' interests in financial difficulties.' It should be noted at the outset that these categories are broader than the doctrinal concept of 'directors' duties' as it appears in many textbooks in all three of the comparator jurisdictions. The analysis in this chapter is intended to cover all rules which create incentives on those who make corporate decisions to take into account the interests of non-adjusting creditors, and therefore includes, for example, rules of criminal and bankruptcy law which apply to directors' conduct within the scope of this dissertation as discussed in Chapter 1.

In a similar manner to Chapters 2 and 3, this chapter will address the two initial research questions of first, whether non-adjusting creditors of private limited companies are sufficiently protected by the law relating to directors' duties and, second, how the law relating to directors' duties has developed. An ESV normative model of corporate governance will be used as the yardstick to evaluate the legal regime, to address the first question, and a comparative analysis focusing on the development of Thai law will be adopted in relation to the second research question, in order to permit the formation of nuanced recommendations for the improvement of Thai law in this area in accordance with the third research question.

This chapter will proceed as follows. The first section will discuss the general nature of directors' duties and the link to the protection of non-adjusting creditors from a theoretical perspective. The second, third and fourth sections will

examine the concept of directors' duties in the three comparator jurisdictions in turn, with the discussion divided into an examination of the development of the relevant legal concepts, directors' general duties towards creditors, specific duties to preserve creditors' interests in financial difficulties, and methods of enforcement. The fifth section provides a comparative analysis of the three jurisdictions' approaches and an evaluation of the Thai legal framework, addressing the two initial research questions of this dissertation. The final section concludes.

4.2 Directors' duties and the protection of non-adjusting creditors

Directors' duties may be thought of as rules which the law "lays directly on the members of the board as to limits within which they should exercise their powers".[1] In other words, directors' duties may be conceived as rules which directly constrain the broad powers given to directors to make corporate decisions, with a view to preventing or remedying abuse of other company stakeholders. This chapter does not provide a general discussion of directors' duties, since much of their focus is on preventing abuse of powers to the detriment of shareholders. Instead, this chapter focuses on those directors' duties which may prevent or remedy abuse of the interests of non-adjusting creditors. As noted in Chapter 1, the three major conceptual types of behaviour which cause harm to non-adjusting creditors – asset dilution, asset substitution and debt dilution – in all cases require action on the part of the company's management, whose conduct is monitored and ratified by the board of directors. As such, a system of effective constraints on directors' decision-making is a potentially fruitful source of protection for non-adjusting creditors.

From a theoretical perspective, there are two broad questions which may be considered in relation to directors' duties and the interests of non-adjusting creditors. First, is there a general duty upon directors to consider the interests of non-adjusting creditors when making corporate decisions at all times? Second, does the position change when the company encounters financial difficulties and has a real prospect of entering into a formal insolvency process?

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[1] P Davies and S Worthington, *Gower's Principles of Modern Company Law* (10th edn, Sweet & Maxwell 2016) 463.

In relation to the first question, there are further related sub-questions which are of significance: (i) to whom is the duty owed, and (ii) what is the content of the duty – i.e., what, if any, effect does such a duty have on the decision-making process of the directors? In respect of the first sub-question, while, as discussed below, all three comparator jurisdictions recognise that directors' duties are owed to the company itself rather than any specific group of stakeholders,[2] who in practice may enforce the duties, directly or indirectly, will clearly have a significant practical effect on the decisions of the directors. Regarding the second sub-question, from an ESV perspective, Jensen, a major proponent of the theory as discussed in Chapter 1, argues that, in managing companies for long-term value promotion:

> "it is obvious that we cannot maximise the long-term market value of an organisation if we ignore or mistreat any important constituency. We cannot create value without good relations with customers, employees, financial backers, suppliers, regulators, communities and so on."[3]

Therefore, to achieve the corporate objective under an ESV perspective, i.e. ultimately maximising shareholder value in the long term, the interests of other stakeholders should be considered. On this basis, it follows that an ESV view of the corporate objective would support consideration of the interests of non-adjusting creditors as always being present in the content of directors' duties. However, while a company is fully solvent and able to pay its debts, it is arguable how much of a role such considerations need play in practice for non-adjusting creditors, who only have an interest in receiving repayment from the company. Indeed, while the company can achieve this, non-adjusting creditors' interests presumably need not be taken into

[2] The statement that directors' duties are owed to the company is sometimes described as 'trite law', since the nature of the company's interests is often indeterminate and a fundamentally problematical concept in corporate law: see Dan D Prentice, 'Creditor's Interests and Director's Duties' (1990) 10 Oxford Journal of Legal Studies 265, 273–7.

[3] Michael Jensen, 'Value Maximisation, Stakeholder Theory, and the Corporate Objective Function' (2001) 7 European Financial Management 297, 309.

account in any decisions which do not threaten the company's ability to continue to do so.[4]

However, in relation to the second question, this analysis changes when the company encounters financial difficulties and faces the prospect of formal insolvency and the probability of not being able to fully satisfy its debts.[5] At this point, as discussed in Chapter 3, the shareholders are replaced by creditors as the residual claimants: the group whose return from the company is affected by management decisions.[6] When creditors become the residual claimants, the ESV justification of ultimately promoting the interests of shareholders falls away; the interests that should ultimately be served under this model of corporate governance are those of the creditors.[7]

As discussed in Chapter 1, non-adjusting creditors are a particularly vulnerable group of creditors in bankruptcy of the debtor. Indeed, they may be seen to be the group of creditors that is first and foremost affected on the failure of the debtor's business, and thus the first of the creditor groups to become residual claimants. Therefore, it is to consideration of their interests that the directors' duties should first shift, from a theoretical perspective, when a company encounters financial difficulties. Indeed, this shift would likely happen some time before formal insolvency proceedings, since by this point a significant part of the value of the company's assets against which non-adjusting creditors could claim will have been lost. The practical difficulties of identifying this moment will be discussed below.[8] In addition, as discussed in earlier chapters, when a company encounters financial difficulties but is not yet in formal insolvency proceedings, the incentives for shareholders to influence management to take decisions which may harm creditors are

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[4] Paul Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' (2006) 7 European Business Organization Law Review 301, 303–5.

[5] Andrew Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66 The Modern Law Review 665, 668.

[6] Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996) 69; Douglas G Baird and Thomas H Jackson, 'Bargaining after the Fall and the Contours of the Absolute Priority Rule' (1988) 55 University of Chicago Law Review 738, 774–5.

[7] Andrew Keay, 'Directors' Duties and Creditors' Interests' (2014) 130 Law Quarterly Review 443, 459–62.

[8] Discussed further below, in relation to English law. See also Rosemary Teele Langford and Ian Ramsay, 'The Contours and Content of the "Creditors" Interests Duty'' (2021) 21 Journal of Corporate Law Studies 85, 91–2.

increased, but the strong protections of formal insolvency procedures are not yet available. For these reasons, the ESV model of corporate governance appears strongly to support a shift of the focus of directors' duties to protect the interests of non-adjusting creditors when the company encounters financial difficulties.

As regards the content of directors' duties to preserve creditors' interests in financial difficulties, the ESV model would, logically, support decision-making to maximise the returns to non-adjusting creditors in the long-term, while considering the interests of other affected constituencies.[9] It would not merely require the directors to refrain from disposing of assets improperly or diverting assets to insiders.[10] Rather, it would require directors to take into account the impact of their decisions on the ability of the creditors to recover their claims.[11] This would support rules of law requiring directors to put the company into a corporate rescue procedure, for example, or even into insolvent liquidation if this would provide the best return for residual claimant creditors in the long term, without causing inappropriate harm to other affected groups.[12]

A further issue concerns the enforcement of directors' duties. As mentioned above, directors' duties are often viewed as being owed to the company. However, this faces an immediate problem of expecting a board of directors to take action in the case of a breach of duties when the breaching director or directors may be in control of the board. Indeed, there is also generally no legal obligation on directors to monitor one another's conduct.[13] One response of the law to this issue is to permit others – shareholders or, potentially, creditors as discussed below – to enforce directors' duties privately through a derivative action on behalf of the company, or directly via a tort claim. However, academics[14] and government reports[15]

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[9] Andrew Keay, *Company Directors' Responsibilities to Creditors* (Routledge 2007) 241–2; Wai Shun Wilson Leung, 'The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime That Recognizes Non-Shareholder Interests' (1996) 30 Columbia Journal of Law and Social Problems 587, 605.

[10] Andrew Keay, 'Financially Distressed Companies, Preferential Payments and the Director's Duty to Take Account of Creditors' Interests' (2020) 136 Law Quarterly Review 52.

[11] Rosemary Teele Langford and Ian Ramsay, 'The "Creditors" Interests Duty': When Does It Arise and What Does It Require?' (2019) 135 Law Quarterly Review 385, 389–90.

[12] Keay, 'Directors' Duties and Creditors' Interests' (n 7) 463–4.

[13] Vanessa Finch, 'Company Directors: Who Cares about Skill and Care?' (1992) 55 The Modern Law Review 179, 197–9.

[14] Andrew Keay, 'An Assessment of Private Enforcement Actions for Directors' Breaches of Duty' (2014) 33 Civil Justice Quarterly 76; Arad Reisberg, *Derivative Actions and Corporate Governance:*

have cast doubt on the efficacy of private enforcement mechanisms in this area. Indeed, of English law it has been said that '[t]he system does not, to any significant extent, rely on formal private enforcement.'[16] This lack of efficacy has led to support in a number of jurisdictions for public enforcement of directors' duties.[17] Indeed, credible enforcement of directors' duties, including the potential to disqualify misbehaving directors from being directors of companies in the future, would likely increase compliance through a deterrent effect.[18] The details of public enforcement of directors' duties, including director disqualification regimes, are discussed further below in relation to each jurisdiction. This chapter now turns to the discussion of the relevant rules, and their development, in each jurisdiction.

4.3 Directors' duties in Thai law

In Thai law, the core provisions on directors' duties are Sections 1167-1169 of the CCC. From these sections, as discussed below, doctrine has developed two general duties: the duty of loyalty and the duty of care. Put briefly, the duty of loyalty requires directors not to act in conflict with, or against the interests of, the company. The duty of care comprises a general duty of directors to perform their functions in the interests of the company with the care of the prudent businessman, and four specific duties enumerated in Section 1168 paragraph 2. Section 1169 provides a mechanism for private enforcement, which includes derivative actions. In addition to the general duties, Thai law provides a number of relevant specific criminal offences in relation to directors' conduct within the scope of this dissertation as discussed in Chapter 1, in particular Sections 40-1 of the Offences Act, which

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Theory and Application (Oxford University Press 2007); Hans-Christoph Hirt, *The Enforcement of Directors' Duties in Britain and Germany: A Comparative Study with Particular Reference to Large Companies* (Peter Lang 2004); Finch (n 13).

[15] Department for Business Innovation and Skills, Transparency and Trust, 'Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business,' Discussion Paper (2013) para 8.13.

[16] John Armour, 'Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment' (2008) The Law and Economics of Corporate Governance: Changing Perspectives 9.

[17] Andrew Keay, 'The Public Enforcement of Directors' Duties: A Normative Inquiry' (2014) 43 Common Law World Review 89; Renee M Jones and Michelle Welsh, 'Toward a Public Enforcement Model for Directors' Duty of Oversight' (2012) 45 Vanderbilt Journal of Transnational Law 343.

[18] Howell E Jackson and Mark J Roe, 'Public and Private Enforcement of Securities Laws: Resource-Based Evidence' (2009) 93 Journal of Financial Economics 207.

apply generally, and Sections 164, 166 and 173 of the BA which focus on the period prior to formal insolvency. The historical background of these provisions will now be discussed, before further analysis of their interpretation and application.

4.3.1 Historical background and developments

The general background of the adoption of the CCC, the Offences Act and the BA has been discussed in Chapter 1. In addition, as discussed in Chapter 2, a detailed review of the specific provisions against their stated origins in the Book of Revised Drafts and notes of the draftsmen has been made, the results of which are displayed in tabular form in Appendix 2. In relation to the provisions on directors' general duties, although a wide variety of sources for the provisions is stated in the Book of Revised Drafts, the final versions of the provisions do not conform precisely to any of the stated sources. Conceptually and structurally Sections 1167-1169 most closely resemble Japanese and German sources, however the detail is markedly different.

Notably, Section 1168, which sets out the duty of care and skill and the specific duties, appears to draw on the German source, and paragraph 1 which contains the careful businessman standard of care is almost identical. Formally, the Thai and German provisions proceed in the same way, with a list of specific duties of directors supplementing the general duty. However, there is a marked divergence: Section 241 of the German Commercial Code contains a list of events which will give rise to liability for directors to compensate the company, all of which focus on breaches of legal capital rules – improper returns of share contributions, payments of dividends, repurchases of shares, issue of shares without payment, return of capital, or payments made when the company is insolvent. This points to the emphasis placed on legal capital rules in the structure of company law in Germany generally, discussed in Chapter 2. By contrast, Section 1168 of the CCC contains four specific duties with a very different scope to the German source: ensuring proper payment of share subscriptions, maintenance of the company's books, distribution of dividends and enforcement of the resolutions of the general meeting. This list does not appear in previous legislation or any of the acknowledged drafting sources. Section 1169, providing for private enforcement, similarly is of mixed origin. Paragraph 1 is similar

in concept to a number of stated sources and appears virtually unchanged from the Partnerships and Companies Act of 1911. However, paragraph 2, a new addition at the time of adoption of Book III of the CCC, draws directly on the German source, providing a right of private enforcement for creditors as well as shareholders. This is discussed in more detail below.

Regarding the criminal provisions in the Offences Act, although as discussed in Chapter 1 the ostensible progress was that the provisions moved from the Partnerships and Companies Act 1911 to the Penal Code, and then to the Offences Act, Sections 40 and 41 do not appear in the earlier legislation. Rather, they are first present only in the Offences Act. Section 40 does not have an apparent source in either English or German (or Japanese) legislation; Section 41 appears conceptually similar to a German source, although the wording is different. Regarding the criminal provisions in the BA, Sections 164 and 166 appear to be based on earlier English bankruptcy legislation, consistent with the drafting programme for the BA generally. However, it is notable that equivalent provisions in the English Bankruptcy Act 1914 did not apply to companies, but only natural persons. In addition, their scope of application is narrower than the Thai provisions. Regarding Section 173, this does not appear to have a source in English law.

Overall, similarly to the previous areas examined in this dissertation, the current Thai provisions appear to have their origins in a number of different pieces of legislation, including both German and English sources. However, there are also several provisions or aspects of provisions which do not seem to have been adopted directly from other jurisdictions, and, in the case of the Offences Act, there has been some further development in the concepts since the adoption of the basic rules of company law with Book III of the CCC. This section will now analyse the modern provisions and their application, looking first at directors' general duties and then at directors' duties to preserve creditors' interests in financial difficulties, before turning to examine methods of enforcement.

4.3.2 Directors' general duties

The duties of directors may be divided into general duties and specific duties. The general duties are to manage the company under the control of the

general meeting of shareholders and in accordance with the company's regulations, i.e. taking all actions required in pursuit of the company's objectives.[19] In addition to these general duties, the directors also have a number of specific duties: particular responsibilities allocated to them by the law. These include ensuring that shareholders have fully contributed the amount required by share subscriptions,[20] keeping the company's accounts and other documents required by law,[21] properly paying dividends,[22] carrying out the decisions made at shareholders' meetings,[23] and calling shareholders' meetings when required.[24]

In relation to the manner in which the directors must perform these duties, two concepts are relevant: the duty of care and the duty of loyalty.[25] The duty of loyalty, gathered from Sections 1167 and 1168 paragraph 3, essentially requires that directors must not act in conflict with, or against the interests of, the company.[26] Section 1167 provides that the relationship between the directors, the company and third parties are governed by the provisions of the CCC relating to agency.[27] Furthermore, Section 1168 provides that directors must not undertake commercial transactions in competition with the company without the consent of the shareholders. Regarding the duty of care, the first paragraph of Section 1168 provides that directors must apply the diligence of a careful businessman in the conduct of the business.[28]

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[19] Section 1144.
[20] Section 1168 para 2(1).
[21] Section 1168 para 2(2).
[22] Section 1168 para 2(3).
[23] Section 1168 para 2(4).
[24] Section 1172.
[25] Sahaton Ratthanapijitr, Explanation of the Principles of Law relating to Partnerships and Companies (6th edn, Winyuchon 2020) (Thai language) 382-4; Sophon Rathanakon, Explanation of the Civil and Commercial Code regarding Partnerships and Companies (12th edn, Nitibannagarn 2010) (Thai language) 406-411; Nontawat Nawatrakulpisut, Law of Partnerships, Limited Companies and Public Limited Companies (4th edn, Winyuchon 2019) (Thai language) 230-233.
[26] Ratthanapijitr (n 25) 398–402.
[27] Particularly relevant here are those Sections which provide that an agent cannot enter into a contract between herself and her principal without consent (s.805), that an agent must hand over to the principal all money and property received in connection with the agency (s.810), and that an agent is liable for harm resulting from negligence or non-performance of agency or from acts done in excess of her authority (s.812).
[28] The standard of the 'careful businessman' means that directors' conduct is judged objectively against how a hypothetical prudent businessman would have acted in the same situation, this being interpreted to be a prudent businessman in the same industry as the relevant director (Ratthanapijitr (n 25) 380.). Therefore, the particular skills and experience of the relevant director are irrelevant in deciding whether or not she has met the standard of care. Tipchanok Ratanosoth, *Explanation of the Provisions of the Law of Partnerships and Companies* (6th edn Thammasat 2013) (Thai language) 367.

Section 1169 provides that claims against the directors for compensation for harm caused by them to the company may be made by the company or, if the company refuses to take action, by the shareholders. The second paragraph of this section provides that such claims may be enforced by creditors of the company, insofar as their claims against the company remain unsatisfied. This implies that the directors' duty of care may be seen as owed *directly* to the company; however, it could also be seen as owed to the shareholders and creditors of the company *indirectly*, to the extent that the latter's claims remain unsatisfied.

Regarding whether or not the directors must consider the interests of non-adjusting creditors when carrying out their duties, the prevailing view appears to be that the directors need only consider shareholders' interests when making decisions.[29] This view is supported by a number of provisions of the CCC which indicate that directors must run the company in accordance with shareholders' resolutions and the articles of association,[30] that shareholders appoint and remove directors, [31] and that shareholders can bring derivative actions to enforce the duties and shield directors from a claim by the company or the approving shareholders for a breach of the duty of care.[32] However, there is also support for a view that directors are required to consider the interests of creditors. The right for creditors to bring claims under Section 1169 paragraph 2 is evidence that the law acknowledges that creditors have an interest in directors taking proper care in the performance of their duties and that harm may fall on them indirectly through harm caused to the company. This would support the view that the duty of care requires directors, acting as prudent businessmen, to consider the shareholders' interests, but also to consider whether their decisions may result in the company being unable to pay its debts.

In Supreme Court case 3199/2545, the defendant failed, among other things, to take into account tax liabilities of the company and to notify the relevant revenue officials of the dissolution of the business as legally required when settling the affairs of the company as director and liquidator. The Supreme Court

[29] E.g. Saravuth Pitiyasak, 'Thai Company Laws and Good Governance Practices of Unlisted Companies' in Sakulrat Montreevat (ed), *Corporate Governance in Thailand* (Institute of Southeast Asian Studies 2006) 93; Nawatrakulpisut (n 25) 231.
[30] Sections 1168 paragraph 2(4) and 1144.
[31] Section 1151.
[32] Section 1169 paragraph 2 and Section 1170.

found that the defendant had breached the duty of care in Section 1168, since he should have known of the tax liability, and was liable to the Revenue Department for the loss. This principle was applied subsequently by the Supreme Court in the relatively recent case 6043/2561, which has similar facts. Although these cases occurred in liquidation, they may be seen as recognition that, at least in some circumstances, the interests of groups other than shareholders – including, here, non-adjusting creditors – are relevant in analysing the directors' duty of care.

4.3.3 Directors' duties to preserve creditors' interests in financial difficulties

When a company is in financial difficulties, it does not appear that there is any generally recognised shift in the directors' duties, other than in the theoretical argument advanced in the previous section, which finds some support in jurisprudence. Indeed, there is no general duty in Thai law for directors to disclose a company's financial position to contracting parties and a failure to pay a sum due under a contract will generally only be considered as a breach of contract by the company, rather than a wrongful act committed by a director, for example, unless the directors knew at the time of making the contract that the company would not be able to perform the obligations.[33] Furthermore, the debtor company cannot initiate liquidation bankruptcy proceedings,[34] and business reorganisation is only available, subject to recent changes in the law further discussed in Chapter 6, for insolvent companies with debts of at least THB10m; there is no requirement for directors to consider or use this process. Rather than civil liability, Thai law instead appears to rely on provisions of criminal law, in the Offences Act and the BA, to deter and punish directors' conduct which is harmful to creditors.

Under Section 40 of the Offences Act, any person who is responsible for the operations of a company, and who knows that a creditor of the company is enforcing or will enforce their debt against the company or will bring a claim to court for payment of a debt, commits a criminal offence if she (i) diverts,

[33] Thai Supreme Court Decisions 927-8/2534, 1473/2508; See discussion in Wuthipong Wongsrikeaw, 'Liabilities of Managing Director in case of the Bankruptcy of Company' (LLM Thesis, Thammasat University 2006) (Thai language) 65–69.
[34] Sections 9-10 BA.

conceals, or transfers the property of the company to another person or (ii) falsely pretends that the company is in debt. However, transfers within the ordinary course of business will not satisfy the *mens rea* of the offence,[35] and the creditor must either bring a case to court for repayment of the debt, or be about to, and the person carrying out the transfer must have known this.[36] Examples include directors who falsely claimed that share capital had been fully paid up, attempting to avoid creditors enforcing a court judgment,[37] and a director transferring land away from the company while a civil case for a debt against it was pending.[38] It should be noted that this offence is very similar to Section 350 of the Penal Code, the only differences being that Section 40 of the Offences Act applies only to those responsible for the operation of juristic persons, and is not a compoundable offence.

Under Section 41 of the Offences Act, any person who is responsible for the operation of affairs of a limited company, and who does any act with the intention to seek any benefit otherwise unobtainable by a lawful means for himself or for any other person and thereby causes loss to the company, commits an offence. This offence requires a specific criminal intention which must include all the following elements: seeking a benefit, the benefit must be unobtainable by law, and they must intend to thereby cause loss to the company.[39] The loss must be caused to the company itself, for example through loss of assets or advantage, rather than to a third party.[40] This offence is primarily intended to protect the shareholders;[41] however, in aiming to ensure the integrity of the company's assets, it will also aim to protect non-adjusting creditors.

In addition to the provisions of the Offences Act, the BA contains a number of offences which apply to the conduct of directors prior to the company's insolvency. Of these, the most relevant are Sections 164, 166 and 173 of the BA. Section 164 applies to the one-year period prior to the filing of a bankruptcy petition. During this period, it is a criminal offence to (i) pledge, mortgage or dispose of

[35] Thai Supreme Court Decisions 452/2541, 4138/2542, 1134/2537, 2900/2532.
[36] Thai Supreme Court Decision 184/2541.
[37] Thai Supreme Court Decision 10570/2558.
[38] Thai Supreme Court Decision 6557/2557.
[39] Thai Supreme Court Decision 5819/2562.
[40] Thai Supreme Court Decision 6647/2560.
[41] Thai Supreme Court Decision 5819/2562.

property acquired on credit, unless in the ordinary course of business and the absence of fraudulent intent is proven, or (ii) conceal, transfer or deliver property dishonestly, or allow another person to encumber property dishonestly, or (iii) allow oneself to be ordered by the court to pay any debt which does not need to be paid. Under Section 166, a debtor who fails to give justifiable reasons for the loss of a large amount of property during the one-year period prior to a bankruptcy petition, or who creates a debt of which repayment can be applied for in a bankruptcy petition without any cause to believe in the prospect of it being paid, commits an offence. Finally, under Section 173, any person who knows of an impending receivership order, and who diverts, conceals, disposes of or manages the property of the debtor dishonestly commits an offence. In respect of all of these offences, directors have the same liability as the debtor in respect of transactions done by each individual.

These criminal offences generally aim at preventing the disposal or concealment of a debtor company's property in the one-year period prior to formal insolvency proceedings, as well as dishonestly creating additional debts or managing the company dishonestly. However, it is notable that these offences, wide-ranging as they are, all require the court to conclude that those making management decisions did so dishonestly. Provided that those making the company's decisions do not do so dishonestly, these criminal provisions will not apply.

4.3.4 Enforcement of directors' duties

Thai law provides for a mixture of private enforcement and public enforcement as regards standards of directors' conduct. In relation to private enforcement, as discussed above, claims for damage caused to the company may be brought, where the company fails to act, by the shareholders or by creditors of the company, insofar as their claims against the company remain unsatisfied. However, as a means of protecting non-adjusting creditors, this mechanism contains at least two major practical issues. First, creditors face the task of finding sufficient evidence to prove their case. This is likely a significant challenge, since creditors, especially non-adjusting ones, will be unable to access any meaningful information about directors' decision-making. Second, such a challenge is only likely to occur when the company is factually insolvent: otherwise, creditors could simply enforce their claims against

the company. Should the creditors successfully pursue a case on behalf of the company against a director, under Section 1169 paragraph 2, the director will be ordered to compensate the company for the loss. This compensation would, where the company is in formal bankruptcy, form part of the assets of the company to be divided in the bankruptcy process. As discussed in Chapter 1, non-adjusting creditors are unlikely to receive any return from this process due to the process' costs and the ranking of their claims. Due to these issues, non-adjusting creditors are unlikely to pursue a claim, with the possible exception of a sophisticated and resourceful non-adjusting creditor such as the Revenue Department, for example in Thai Supreme Court Decision 3199/2545 discussed above. This weakens the utility of the process as a remedy or a deterrent.

In relation to public enforcement, Thai law has a number of criminal provisions related to directors' conduct in the Offences Act and the BA as discussed above. It should be noted that under Section 160 of the BA, the insolvency office holder is empowered to be an enquiry official under the Criminal Procedure Code in relation to any apparent wrongdoing discovered in the discharge of her duties.[42] Therefore creditors who suspect a breach of the BA's criminal provisions have the following options: they can initiate a case at court themselves, make a complaint to the insolvency office holder, or the insolvency office holder may pursue a case without any outside complaint.[43] However, this only constitutes public enforcement of conduct within the scope of the specific criminal offences, as described above, when such can be proved to the criminal standard, rather than of the more general duty of directors to consider the interests of non-adjusting creditors.

Regarding the potential to disqualify misbehaving directors from acting as directors in the future, Section 50 of the Penal Code provides that, where a court gives a verdict for criminal punishment of a person, and the court is of the opinion that the person committed the offence by taking an opportunity of, or on account of, her occupation, and is of the opinion that such person will commit the offence again if she carries on such occupation, the court may prohibit her from

[42] Thai Supreme Court Decision 288/2516.

[43] Auen Kunkeaw, *Bankruptcy Law* (13th edn, Krungsiam Publishing Co, Ltd 2016) 346 (Thai language). See also Order of the Legal Execution Department 457/2549 on the Conduct of Criminal Cases under the Law of Bankruptcy.

carrying on the occupation for up to five years. However, this appears generally interpreted not to apply to holding the position of director, which is not considered a profession or occupation within the meaning of this section,[44] the interpretation of which will likely be narrow due to the potential conflict with constitutional protections of freedom of occupation.[45]

Finally, the CCC, in Sections 1215-20, provides a procedure for an inspector to be appointed to examine the affairs of a limited company and make a report, including powers to request all of the company's books and documents and examine directors and employees under oath. Although the procedure envisages a request by shareholders holding at least a fifth of the limited company's shares, Section 1220 also empowers the competent Minister to appoint inspectors within their discretion, which might assist creditors in proving misconduct of directors. However, the relevant order and regulations do not provide for this latter power,[46] and the inspection is fact-finding in nature. As a result, this does not constitute public enforcement of duties of directors to consider creditors' interests.

4.4 Directors' duties in English law

In English law, the core provisions on directors' duties are contained in Sections 170-177 CA 2006, although as discussed below the previous case law remains relevant. Jurisprudence has recognised a shift in these duties when a company is in financial difficulties, where creditors' interests are to be treated as paramount. In addition, English law provides for liability for directors in relation to fraudulent trading, which may be criminal or civil, and wrongful trading. Although private enforcement of directors' duties by creditors directly is very weak, in the case of companies in formal insolvency procedures, the insolvency office holder has a number of viable enforcement options on creditors' behalf. Moreover, English law's

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[44] Jitti Tingsapat, *On the Criminal Code Part 1 Title 1* (11th edn, Office of Legal Education Training of the Thai Bar Association 2012) (Thai language).
[45] Section 40 Constitution of the Kingdom of Thailand of 2017.
[46] Order of the Ministry of Commerce 647/2557 on Transfer of the Power to Appoint an Inspector and Conduct of Inspections of Limited Companies to the Director-General of the Department of Business Development; Regulations of the Department of Business Development on Criteria and Methods in the Inspection of Limited Companies, Inspecting the Activities of Public Limited Companies and Paying a Security Deposit for the Inspection of Limited Companies, Inspecting the Activities of Public Limited Companies BE 2554.

regime in relation to public enforcement, particularly the director disqualification regime under the Company Directors Disqualification Act 1986 ("CDDA") is a very notable feature.

4.4.1 Historical background and developments

This section traces the historical development of the concept of directors' duties, and specifically directors' duties to consider the interests of creditors, in English law. The CA 2006 made a fundamental change in this area of law which, until this statute, had been developed almost entirely by the courts. In relation to the development of uncodified directors' duties, being a mixture of equitable principles and common law rules, which are still relevant following the enactment of the CA 2006, the discussion may be divided into the development of the duty of loyalty and the duty care. Following this, the intervention of the CA 2006 will be dealt with.

The duty of loyalty was developed by the courts of equity through analogy to the duties of trustees.[47] Although some academics claim that the analogy arose due to the practice of using a deed of settlement to create a business structure akin to a company, vesting the business' assets in a trustee, prior to the Joint Stock Companies Act 1844,[48] there is little evidence for this.[49] Indeed, it may have been the case that the Courts of Chancery, in earlier cases, used the word 'trustee' because the distinction between the technical nature of the 'trustee' as distinct from the more general 'fiduciary' was not developed until well into the 19th century.[50] A director's fiduciary duties arise essentially through two features of the role: as a member of the board, a director has control over property which in equity belongs to the company; second, by accepting the office and carrying out directors' functions, she holds herself out as undertaking to act in the interests of the company.[51] From the first of these features flows a duty to act within her authority[52] and a duty to exercise her discretion

[47] Davies and Worthington (n 1) 485–6.
[48] Leonard S Sealy, 'Fiduciary Relationships' (1962) 20 Cambridge Law Journal 69.
[49] Leonard S Sealy, 'The Director as Trustee' (1967) 25 Cambridge Law Journal 83, 83–5.
[50] ibid 85; Sealy (n 48).
[51] Sealy (n 49) 85.
[52] *Re Exchange Banking (*1882) 21 Ch D 519, 535-6.

honestly in the interests of the company,[53] a breach of which would result in a requirement to account to the company.[54] From the second feature flows requirements to avoid conflicts of interest and account for secret profits[55] or advantages.[56]

By contrast, the duty of care and skill was developed primarily[57] through the courts of common law, a breach of which therefore resulted in damages. Initially, the courts implied a very low standard of care, on the basis that the company should bear the consequences of having appointed an underperforming director.[58] The classic expression of this view is in the 1925 decision of *Re City Equitable Fire Insurance Co*[59] which was a fundamentally subjective test, requiring no greater degree of care and skill than may be expected of a director with *her own* knowledge and experience. However, in the later part of the 20th century, the courts shifted towards a more demanding and objective standard, in particular influenced by the new statutory requirement in the IA86 in relation to wrongful trading, discussed below.[60] This is reflected in the statutory statement of this duty in the CA 2006.

In relation to the question of to whom the duties are owed, the traditional position was that directors owed their duties to the company, which means acting in the long-term interests of the shareholders as a general body.[61] Non-shareholder interests were not considered part of the legal definition of the interests of companies.[62] However, in 1976 the High Court of Australia[63] recognised a requirement on directors to consider the interests of creditors as the company nears insolvency, which inspired a similar change in a number of Commonwealth jurisdictions.[64] This concept found its way to English jurisprudence in 1988,[65] where

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[53] *Re Beloved Wilkes's Charity* (1851) 3 Mac & G 440, 448.
[54] Sealy (n 49) 91–6.
[55] Sealy (n 48) 79–81.
[56] *Cook v Deakins* [1916] 1 AC 554
[57] Initially, the duty was developed in the courts of equity, with a resulting conflict in the doctrinal method for assessing compensation or damages for breach, and associated concepts. See Davies and Worthington (n 1) 484.
[58] *Overend Gurney & Co v Gurney* (1869) LR 4 Ch App 701, 720.
[59] [1925] Ch 407.
[60] Davies and Worthington (n 1) 479.
[61] *Hutton v West Cork Railway* (1883) Ch D 654, 673; *Parke v Daily News* [1962] Ch 927, 963
[62] See discussion in Daniel Attenborough, 'Misreading the Directors' Fiduciary Duty of Good Faith' (2020) 20 Journal of Corporate Law Studies 73, 81–3.
[63] *Walker v Wimborne* (1976) 137 CLR 1 (Australia).
[64] See discussion in Langford and Ramsay (n 8) 87–9.
[65] Liquidator of West Mercia Safetywear Ltd v Dodd [1988] BCLC 250.

the court approved of a similar statement in the New South Wales Court of Appeal case of *Kinsella*,[66] on the basis that the creditors become the company's residual claimants in factual insolvency.[67]

With the CA 2006, the legislature took the opportunity to codify directors' duties through a statutory 'high-level' restatement of common law principles.[68] This restatement, now primarily contained in Sections 170-77 of the CA 2006, is intended, through its high-level conceptual status, to allow the courts room to apply the principles to the changing circumstances of commercial life.[69] Furthermore, Section 170(3) and (4) make it clear that the duties are based on common law rules and equitable principles and are to be interpreted and applied in the same way, thus preserving much of the existing case law. However, the CA 2006 in fact makes important clarifications or alterations to the previous position, in particular, for the purposes of this chapter, through the explicit adoption of an ESV approach to the corporate objective as discussed below.

4.4.2 Directors' general duties

As discussed above, directors' duties are now generally codified in Sections 170-177 of the CA 2006. Section 170 provides the context for the duties which are detailed in Sections 171-177. Section 170 makes clear that the duties are owed by directors to the company;[70] therefore, only the company, or shareholders pursuing a derivative action on behalf of the company[71] can enforce the duties. Section 170 also makes it clear that the duties are based on common law rules and equitable principles, and should be interpreted accordingly, confirming explicitly that previous case law will continue to be relevant. Furthermore, Section 178 provides that the consequences of breach of Sections 171-177 are the same as would apply if the corresponding common law rule or equitable principle applied. This means that, with

[66] Kinsela v Russell Kinsela Pty Ltd (in liq) Street (1986) 4 NSWLR 722 (Australia)
[67] E.g. *Bilta (UK) Ltd v Nazir* [2015] UKSC 23, per Lord Sumption [104].
[68] 'Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties', Law Com No 261 and Scot Law Com No 173 (TSO, 1999); Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy: The Strategic Framework', URN 99/654 (DTI, 1999).
[69] Davies and Worthington (n 1) 464.
[70] This codifies the previous position, from the case of *Percival v Wright* [1902] 2 Ch 421.
[71] Under Part 11 of the CA 2006.

the exception of Section 174 – the duty of care and skill which has a common law origin, as above – the duties are enforceable in the same way as any other fiduciary duty owed to a company by the directors, using equitable remedies: constructive trust, account of profits, equitable compensation, and recission, with an injunction available for a threatened breach.

The nature of the statutory duties in Sections 171-177 are, in summary, as follows: the duty of directors to act within their powers (171), the duty to promote the success of the company (172), the duty to exercise independent judgment (173), the duty to exercise reasonable care, skill and diligence (174), the duty to avoid conflicts of interest (175), the duty not to accept benefits from third parties (176) and the duty to declare an interest in a proposed transaction or arrangement (177). From the perspective of non-adjusting creditors, a crucial consideration is whether the duty to promote the success of the company, under Section 172, includes taking into account the interests of creditors.

Section 172(1) is an explicit adoption of an ESV approach, replacing the previous position discussed above.[72] It provides that a company director must act in the way in which she, in good faith, considers would be most likely to promote the success of the company for the benefit of its members (i.e., shareholders) as a whole. However, in doing so the directors must have regard among other matters to the likely consequences of any decision in the long term, the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers and others, the impact of the company's operations on the community and the environment, the desirability of the company maintaining a reputation for high standards of business conduct, and the need to act fairly as between members of the company. As an ESV-inspired statement, this provides that the ultimate interests that should be served, in general, are those of the shareholders but that in doing so a number of other interests must be taken into account. Essentially, the board must balance the different interests and decide what, ultimately, is best for the company's success in the long term: the result of the balancing exercise appears to be a matter for the directors' business judgment, subject to the

[72] Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy: The Strategic Framework', URN 99/654 (DTI, 1999) paras 5.1.1, 5.1.12 and 5.1.17–5.1.23.

requirements of good faith.[73] However, a notable exclusion from the list of interested groups is the creditors as a class, although suppliers and customers are mentioned, two important groups of non-adjusting creditors.

However, creditors are mentioned directly in Section 172(3), which provides that the duty imposed by Section 172 has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company. This, although unhelpfully vague, appears to adopt the concept already accepted in case law, as discussed above and further below, that in factual insolvency the directors must consider the interests of creditors as paramount.[74] Arguably the reason for creditors appearing here, rather than their interests appearing in the list in 172(1), is that their interests are considered only relevant when they become, or are likely to become, the residual claimants; at that point, rather than still ultimately serving shareholders' interests under Section 172(1), the directors should only serve creditors' interests. This chapter will now discuss the position when the company is in financial difficulties.

4.4.3 Directors' duties to preserve creditors' interests in financial difficulties

The duties of directors to preserve creditors' interests in financial difficulties have two primary sources in English law: first, the concept that there is a shift in the nature of general directors' duties as a company nears insolvency, recognised through court decisions and incorporated into statutory law via Section 172(3) of the CA 2006 as mentioned above; and second, the concepts of fraudulent and wrongful trading through Sections 213-4 of the IA86. In addition, there is potential criminal liability for fraudulent trading under Section 993 of the CA 2006

Regarding the shift in directors' duties to preserve creditors' interests, two questions must be addressed: when does the duty arise, and what does the duty require? Regarding the first question, this was considered recently, in 2019,

[73] See e.g. *R (on the application of People and Planet) v HM Treasury* [2009] EWHC 3020 (Admin); See also Explanatory Notes to the CA 2006, <http://www.legislation.gov.uk/ukpga/2006/46/notes/contents> accessed 11 November 2022, para 327.
[74] Parker Hood, 'Directors' Duties Under the Companies Act 2006: Clarity or Confusion?' (2013) 13 Journal of Corporate Law Studies 1, 22–5.

by the Court of Appeal.[75] After an extensive review of existing authorities, David Richards LJ, writing the leading judgment, concluded that the duty arises when the directors know or should know that the company is or is likely to become insolvent; "likely", here, means "probable".[76] Regarding what the duty requires, the more recent cases formulate the duty as requiring that the directors must treat creditors' interest as "paramount."[77] This formulation has also been advocated for by Andrew Keay,[78] a leading academic in this area, and appears to also be supported by Richards' *dicta* in *BTI v Sequana*[79] mentioned above. This concept does not mean that shareholders' interests are ignored, but rather that the interests of creditors are given priority.[80] In practical terms, this would mean avoiding excessive risk-taking and entering into undervalue transactions, and prioritising the ability of creditors to receive sums due to them.[81]

Under Section 213 of the IA86, if, in the course of a company's liquidation or administration,[82] it appears that the company has been carried on with intent to defraud creditors, or for any fraudulent purpose, the court may declare that persons who were knowingly party to carrying on the business in this manner are to be liable to make such contributions to the company's assets as the court thinks proper. The purpose of this section is to compensate rather than to punish.[83] However, the requirement of 'dishonest intent'[84] and strict standards of pleading and proof result in severe difficulty in succeeding for a claim of civil liability under this section.[85] Section 993 of the CA 2006 provides for the criminal offence of fraudulent trading,

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[75] BTI 2014 LLC v Sequana SA [2019] EWCA Civ 112.
[76] Ibid, at [183]ff.
[77] *Re HLC Environmental Projects Ltd; Hellard v Carvalho* [2013] EWHC 2876 (Ch) [92]. See discussion in Langford and Ramsay (n 11) 95–6.
[78] Keay, 'Directors' Duties and Creditors' Interests' (n 7) 454.
[79] [2019] EWCA Civ 112 at [222].
[80] Langford and Ramsay (n 11) 106.
[81] Andrew Keay, *Directors' Duties* (3rd edn, LexisNexis 2016) pt 13.91-13.93. Mark Arnold and Marcus Haywood, 'Duty to Promote the Success of the Company' in Simon Mortimore (ed), Company Directors: Duties, Liabilities and Remedies (2nd edn, Oxford University Press 2013) pt 12.63.
[82] Fraudulent and wrongful trading provisions were extended to apply to administration as well as liquidation by the Small Business and Enterprise Act 2015: see ss.246ZA and 246ZB respectively
[83] Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (2nd edn, Cambridge University Press 2009) 696.
[84] Royston Miles Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell 2011) 659–62.
[85] Finch and Milman (n 83) 697–8.

with the same test as that under Section 213, although this Section does not require the company to have entered a formal insolvency process.

Section 214 IA86, on wrongful trading, owes its origins to the Cork Report, discussed in detail in Chapter 3, and it was seen by the Committee, as well as academics, as a potentially valuable tool to protect unsecured creditors.[86] Under this Section, where a company has gone into liquidation or administration, if, at some point before its commencement, a director knew or ought to have concluded that there was no reasonable prospect of the company avoiding insolvent liquidation or insolvent administration, the court may declare that the director is liable to make such contribution to the assets of the company that the court thinks proper. The court will not make such declaration if it is satisfied that the director "took every step with a view to minimising the loss to the company's creditors" as she ought to have taken.[87] For this purpose, the conduct of the director is judged by the standard of a reasonably diligent person having (a) the general knowledge, skill and experience of someone carrying out the same functions as that director and (b) that of the director herself.

However, in spite of the high hopes for this provision, in practice there have proved to be a number of barriers facing liquidators successfully using this provision, including the fact that a number of judges have interpreted the provision to require clear evidence of wrongdoing, and to require liquidators to be able to pinpoint the exact moment in time that the director ought to have known that the company had no reasonable prospect of avoiding insolvent liquidation.[88] Furthermore, the high costs for the liquidator in bringing a case are also thought to be prohibitive.[89] More successful have been disqualification proceedings under the CDDA, as discussed in the next section.

4.4.4 Enforcement of directors' duties

[86] ibid 698; Fidelis Oditah, 'Wrongful Trading' (1990) 218 Lloyd's Maritime and Commercial Law, Quarterly; Andrew Keay, 'Wrongful Trading: Problems and Proposals' (2014) 65 Northern Ireland Legal Quarterly 63, 64–5.
[87] 214(3) IA86.
[88] Keay, 'Wrongful Trading: Problems and Proposals' (n 86) 67–72; Finch and Milman (n 83) 698–703; Goode (n 84) 682–3.
[89] Keay, 'Wrongful Trading: Problems and Proposals' (n 86) 69–72.

The general directors' duties under the CA 2006 can be privately enforced by the company, by a majority of shareholders in the general meeting, or by a derivative claim under Part 11 of the CA 2006.[90] Thus, creditors cannot enforce general directors' duties directly. However, when a company enters into formal insolvency proceedings, the insolvency office holder has several options available to exercise on behalf of creditors: she can bring proceedings in the name of the company for breach of directors' duties which the company could have brought prior to the insolvency proceedings; alternatively, in liquidation,[91] she, or any creditor, can bring an action under the summary procedure in Section 212 of the IA86, for misfeasance or a breach of any fiduciary or other duty to the company. Here, the term 'misfeasance' is not a distinct wrongdoing[92] but covers any breach of duty causing loss to the company including by misappropriation or through improper payments including distributions from capital or wrongful preferences,[93] secret profits or other benefits from breaches of fiduciary duties and claims for negligence.[94] Under Section 212(3), the court may compel the offending director to repay or restore the property to the company, with interest, or to contribute such sum to the company by way of compensation that the court thinks just. However, it should be noted that, under Section 1157 of the CA 2006, for negligence, default, breach of duty or breach of trust, if it appears to the court that the director acted honestly and reasonably, and that having regard to the circumstances of the case she ought fairly to be excused, the court may relieve her, in whole or part, of liability.

Regarding fraudulent and wrongful trading, applications for an order can be made by liquidators or administrators.[95] The criminal sanction for fraudulent trading is a fine or imprisonment or both.[96] There are five civil sanctions, which apply to both fraudulent trading and wrongful trading: (1) declaration by the court for the defendant to make such contribution to the company's assets that the court thinks fit; (2) further declarations to give effect to the declaration to contribute,

[90] Davies and Worthington (n 1) 591–6.
[91] The summary procedure is not available in administration: *Irwin v Lynch* [2010] EWHC 153.
[92] Re Continental Assurance Co of London Plc [2001] BPIR 733.
[93] Keay, 'Financially Distressed Companies, Preferential Payments and the Director's Duty to Take Account of Creditors' Interests' (n 10).
[94] Goode (n 84) 652–3.
[95] Sections 213(2), 246ZA(2), 214(1), 246ZB(1) IA86.
[96] Section 993(3) CA2006.

including a charge over the director's assets; (3) such further orders as may be necessary for enforcing the charge; (4) if the director is also a creditor of the company, subordination of her debt; and (5) disqualification.[97] The court's power to give relief under Section 1157 of the CA 2006 is not applicable to wrongful trading.[98]

The CDDA, created following a recommendation of the Cork Committee,[99] consolidated the law relating to the ability for the court to disqualify directors, which stretches back to the 1920s.[100] The purpose of the CDDA is the protection of the public – broadly defined to include all relevant interested groups including lenders, customers and other creditors[101] – through a deterrent effect on further misconduct and encouraging higher standards in corporate management.[102] Disqualification is a civil rather than criminal matter.[103] Although there are many grounds[104] on which a person may be disqualified under the CDDA, in practice the majority of disqualification orders are made under Section 6, which concerns the duty on the court to disqualify unfit directors of insolvent companies.[105]

Under Section 6 CDDA, the Secretary of State or the official receiver[106] – in practice, the UK's Insolvency Service[107] – may apply to the court for a disqualification order where a director has been the director of a company which

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[97] Sections 213(2), 213(1), 215(2)-(4) IA86; 4(1)(a), 10 CDDA.
[98] Re Produce Marketing Consortium Ltd (1989) 5 BCC 399.
[99] Kenneth Cork, 'Report of the Review Committee on Insolvency Law and Practice' (1982) Cmnd 8558 para 1808; Davies and Worthington (n 1) 235.
[100] Section 75 of the Companies Act 1928. For a history of the development of the law in this area, see *Official Receiver v Wadge Rapps & Hunt (A Firm)* [2003] UKHL 49 [32]-[42].
[101] Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane [1998] 1 BCLC 259 at 268; Hill v Secretary of State for the Environment, Food and Rural Affairs [2006] 1 BCLC 601 at 608
[102] Re Blackspur Group plc, Secretary of State for Trade and Industry v Davies [1998] 1 BCLC 676 at 680.
[103] Brenda Hannigan, *Company Law* (3rd edn, Oxford University Press 2012) 670.
[104] Including where a person has been convicted of an indictable offence in relation to a company (Section 2); persistent default in respect of filing documents with the companies' registrar (Section 3); fraudulent trading or other fraud (Section 4); where an investigation shows a person to be unfit (Sections 1A, 8); infringement of competition law (Sections 9A–9E); where civilly liable under Section 213 (fraudulent trading) or 214 (wrongful trading) of the IA86 (Section 10).
[105] Hannigan (n 103) 670; Tess Blackie and Jean Jacques Du Plessis, 'Australia' in Jean Jacques Du Plessis and Jeanne Nel de Koker (eds), *Disqualification of Company Directors: A Comparative Analysis of the Law in the UK, Australia, South Africa, the US and Germany* (Taylor & Francis 2017) 50. Insolvency Service, 'Enforcement Outcomes 2019-20' <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/880687/Commentary_-_Insolvency_Service_Enforcement_Outcomes_2019-20.pdf> accessed 11 November 2022, 7
[106] Section 7(1) CDDA.
[107] Blackie and Du Plessis (n 105) 51.

became insolvent (either while she was a director or subsequently) and her conduct makes her unfit to be concerned in the management of a company.[108] Insolvent, here, means entering into a formal insolvency process.[109] In considering the unfitness of the director, the court must have regard to the matters listed in Schedule 1 to the CDDA.[110] These include the extent to which the director was responsible for contravention of applicable legislative or other requirements, for the company becoming insolvent, and the nature and extent of any loss caused by her conduct, any misfeasance or breach of fiduciary duty, material breaches of legislative or other duties and the frequency with which the director has engaged in the relevant conduct.

In relation to the interpretation of these provisions by the courts, Davies and Worthington separate the cases into two categories: probity and competence.[111] The first has at its centre the idea of conducting a business at the expense of creditors: for example, paying only those creditors who press for payment and taking advantage of those creditors who do not in order to provide working capital.[112] In relation to competence, it seems that incompetence or very serious negligence is sufficient, such as failure to maintain a sufficient knowledge and understanding of the company's business to enable a director to discharge her duties.[113] Statistically, the most common allegation is unfair treatment of the Crown, which usually refers to a situation where a director has made a conscious decision to pay creditors other than HM Revenue and Customs or has defrauded the latter.[114]

The Insolvency Act 2000 introduced the idea of a "disqualification undertaking" in the cases of unfitness: the Secretary of State and the relevant director may reach an agreement out-of-court on a disqualification undertaking in the same way as a disqualification order made by the court, but without the hearing.[115] The effect of a disqualification order or undertaking is that the relevant person must not be

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[108] Section 6(1) CDDA.
[109] Section 6(2) CDDA.
[110] Section 12C(4) CDDA.
[111] Davies and Worthington (n 1) 245–8.
[112] Re Stevenoaks Stationers (Retail) Ltd [1991] Ch 164; Secretary of State for Trade and Industry v McTighe (No 2) [1996] 2 BCLC 477.
[113] *Re Barings Plc (No.5)* [2000] 1 BCLC 523; Davies and Worthington (n 1) 246–7.
[114] Insolvency Service, 'Enforcement Outcomes 2019-20' <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/880687/Commentary_-_Insolvency_Service_Enforcement_Outcomes_2019-20.pdf> accessed 11 November 2022, 10.
[115] Section 1A CDDA.

a director of a company, directly or indirectly, or take part in the promotion, formation or management of a company without leave of the court for a minimum of 2 and a maximum of 15 years, as specified in the order or undertaking.[116] In addition, the court may make an order for the director to pay compensation, considering the loss caused and the nature of the conduct, as a contribution to the assets of the company or to the Secretary of State for the benefit of a creditor or a class or classes of creditor.[117] In the reporting year 2019-20 there were 1,280 director disqualifications in the UK, of which 1,116 were by way of undertakings and 164 by court order.[118]

4.5 Directors' duties in German law

In German law, the core provision regarding directors' duties is Section 43 of the GmbH Act. Written in very general terms, its interpretation has been significantly developed by the courts, to cover both a duty of care and a duty of loyalty. Creditors' interests are to be considered in the application of this duty, as discussed below. Furthermore, the courts have recognised that in certain circumstances directors owe direct tortious liability to creditors, which may be enforced both in and outside of the company's insolvency. In addition, legislative amendments have placed a requirement on directors to swiftly place failing companies into formal insolvency, under Section 15a InsO. A breach of this results in criminal and potentially significant civil liability, along with consequent disqualification for directors.

4.5.1 Historical background and developments

The general background of the GmbH Act and the InsO have been discussed in Chapters 2 and 3 respectively. However, the GmbH Act does not contain a detailed description or numerous specific provisions concerning the content and scope of directors' duties. Rather, it has been for the courts, scholarship and legal

[116] Sections 1-1A CDDA.
[117] Sections 15A-15B CDDA.
[118] Insolvency Service, 'Enforcement Outcomes 2019-20' <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/880687/Commentary_-_Insolvency_Service_Enforcement_Outcomes_2019-20.pdf> accessed 11 November 2022, 6.

practice to develop the norms that are attached to the concept of the prudent director, the standard to which a director is held under Section 43(1) GmbH Act, which has been in its current form since 1892.[119] Indeed, the concept of *Treuepflicht*, or the duty of loyalty, is not referred to in the Act, but is a relatively recent creation of doctrinal writing and judicial decisions.[120] For example, in a case in 1985, the German Federal Court extended a director's duty not to compete with a company, found in previous cases,[121] to the period after a director had left office.[122] This was on the basis that the director failed to use appropriate diligence by not taking advantage of the relevant opportunity when he was still a director. This is an example of the German Federal Court developing the duty of loyalty out of the general standard of diligence, compared with the English court's development based on fiduciary principles connected to the law of trusts, not present in German law.[123] An additional important example is the development of the concept of a direct liability in delict, discussed further below, between the directors of a GmbH and creditors, which was made by the German Federal Court in the 1989 *Baustoff* (building materials) case based on Section 823(1) BGB.[124]

There have also been some important legislative changes in relation to directors' liability relevant to the protection of creditors. In 1980, the regime relating to liability of directors for false statements in relation to company incorporation, and for failure to ensure that share capital is properly paid, was strengthened.[125] In 1999, the InsO came into force, one of the aims of which was to address the problem of 'asset-starved insolvencies,' requiring directors to put failing companies into formal insolvency quickly before assets have been eroded. In addition, the MoMiG, discussed in Chapter 2, made a number of amendments in 2008 with the objective of increasing protection against abusive practices by management. These

[119] Thomas Bachner, Creditor Protection in Private Companies: Anglo-German Perspectives for a European Legal Discourse (Cambridge University Press 2009) 152–3.
[120] ibid 155–6.
[121] BGH, Judgment of 9 November 1967 (BGHZ 49) 30.
[122] BGH, Judgment of 23 September 1985 (NJW 1986) 585.
[123] Klaus J Hopt, 'Klaus Hopt, "Self-Dealing and Use of Corporate Opportunity and Information: Regulating Directors" Conflict of Interest'' in Klaus J Hopt and Gunther Teubner (eds), *Corporate governance and directors' liabilities: legal, economic and sociological analyses on corporate social responsibility* (de Gruyter 1985) 295.
[124] BGH, Judgment of 5 December 1989 (BGHZ 109) 297.
[125] Enno W Ercklentz, 'The GmbH Law Amendments of 1980' (1981) The International Lawyer 645.

include reforms in relation to liability for management in the case of payments made to shareholders which result in the company's illiquidity and a requirement, in the event of illiquidity or over-indebtedness, to immediately file an application for insolvency.[126]

Furthermore, the 1980 reforms created a specific disqualification regime for directors: prior to this, only occupational bans in criminal law and trade law were available, which had little relevance in practice for company directors.[127] The regime, based on academic and governmental research on insolvency conducted in the 1970s, created specific bans based on criminal, trade and insolvency offences rather than a general provision enabling the courts to disqualify a director based on unfitness, which was not recommended due to concerns over unconstitutionality.[128] In the mid-2000s, the regime was criticised as being overly narrow, in particular by not including the failure to file for insolvency proceedings as grounds for disqualification.[129] Therefore, the MoMiG also revised and expanded the rules on director disqualification to include additional criminal offences against property including fraud and giving false statements, as well as intentional delay in filing for insolvency proceedings. However, disqualification now requires an intentional act; negligence alone is not sufficient. Therefore, although the grounds for disqualification have been expanded, these requirements also limit the scope of their application. This section will now examine the current legal position in detail.

4.5.2 Directors' general duties

The statutory duties in German law on directors are primarily contained in the GmbH Act, the BGB and the HGB. Directors' duties are owed to the

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[126] Martin Schulz and Oliver Wasmeier, 'Limited Liability Company (GmbH)', *The Law of Business Organizations* (Springer 2012) 82–4; Michael Beurskens and Ulrich Noack, 'The Reform of German Private Limited Company: Is the GmbH Ready for the 21st Century?' (2008) 9 German Law Journal 1069, 1088–9; Ulrich Noack and Michael Beurskens, 'Modernising the German GmbH—Mere Window Dressing or Fundamental Redesign?' (2008) 9 European Business Organization Law Review 97, 119.

[127] Andreas Rühmkorf, 'Germany' in Jean Jacques du Plessis and Jeanne Nel de Koker (eds), Disqualification of Company Directors: A Comparative Analysis of the Law in the UK, Australia, South Africa, the US and Germany (Taylor and Francis 2017) 176.

[128] ibid.

[129] T Drygala, 'Zur Neuregelung der Tätigkeitsverbote für Geschäftsleiter' (2005) Zeitschrift für Wirtschaftsrecht (ZIP) 423, 425 (German language).

company. However, directors acting in breach of their duties may owe either 'internal liability' to the company or 'external liability' to third parties which, since it is usually observed in the case the company's insolvency, is dealt with in the next section.[130] There are a number of specific duties arising under statute, including, relevant to protection of non-adjusting creditors, forming and raising share capital,[131] preservation of share capital,[132] and the duty to file a petition for insolvency proceedings.[133]

As for the other two comparator jurisdictions, directors' general duties can be separated into the duty of care (*Sorgfaltspflicht*) and the duty of loyalty (*Treuepflicht*). Regarding the duty of care, directors must conduct the company's affairs with the care of the prudent businessman.[134] This is an objective standard, although it requires both unlawfulness of the act and culpability of the person committing the act.[135] For example, a director whose conduct objectively falls below the required standard will escape liability if she relies on the advice of an independent, suitably qualified professional expert with sufficient information and access to all relevant documents.[136] However, it is generally agreed that where loss is caused to the company by a breach of duty, a lack of diligence is presumed and it will be for the director to disprove culpability.[137] The standard is generally tied to the type of business being performed, but special knowledge or competence of the relevant director may raise the standard.[138]

Regarding the duty of loyalty, this is a duty to safeguard the interests of the company, which generally means to focus on the good of the company

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[130] Katharina Haehling von Lanzenauer and Oliver Sieg, 'Germany' in Edward Smerdon (ed), *Directors' liability and indemnification: a global guide* (2nd ed., Globe Law and Business 2011) 119.
[131] Directors may be liable for false statements that payments have been made: Section 9a para 1 GmbH Act.
[132] Directors must refrain from making payments to a shareholder if these would lead to the insolvency of the company: Section 64 GmbH Act.
[133] Section 15a para 1 InsO.
[134] Section 43 GmbH.
[135] Bachner (n 119) 154; Basil S Markesinis and Hannes Unberath, *The German Law of Torts: A Comparative Treatise* (4th edn, Bloomsbury Publishing 2002) 79–85.
[136] BGH, Judgment of 14 May 2007 (NJW 2007) 2118.
[137] Through analogy with Section 93 (2) AktG, see discussion in Bachner (n 119) 158.
[138] Haehling von Lanzenauer and Sieg (n 130) 122.

to the exclusion of the interests of the director or third parties.[139] The duty of loyalty includes duties of confidentiality, non-competition and to make use of corporate opportunities only in the interests of the company.[140] The interests of the company means mediating different interests of various constituencies including creditors, employees, consumers and society as well as shareholders.[141] However, where instructions are issued by the shareholders' meeting, directors are bound to follow them and will not be liable even where it is not in the best interests of the company, provided that they do not conflict with mandatory provisions of company law, the articles of association, or the fiduciary duty to act in good faith.[142]

4.5.3 Directors' duties to preserve creditors' interests in financial difficulties

Although, as mentioned above, consideration of creditors' interests is required generally, there are also specific personal liabilities of directors, potentially incurred directly in favour of creditors, when a company encounters financial difficulties. These liabilities arise through the application of tort law, under Section 823 of the BGB.

Section 823(1) of the BGB provides a general basis for liability in tort, incidentally in virtually identical terms as Section 420 of the Thai CCC: a person who wilfully or negligently unlawfully injures the life, body, health, freedom, property or another right of another person is liable to make compensation.[143] The directors of a GmbH owe organisational duties (*Organisationspflichten*) to provide adequate procedures and controls within the company's organisation to ensure smooth operation.[144] Although a breach of this duty resulting in damage will usually result in internal liability, i.e. liability to the company, the courts have also ruled in favour of external liability, i.e. liability to third parties who suffer loss as a result of a breach of

[139] Andreas Cahn and David C Donald, Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA (Cambridge University Press 2010) 340.
[140] Schulz and Wasmeier (n 126) 98.
[141] Cahn and Donald (n 139) 335.
[142] Klaus J Müller, The GmbH: A Guide to the German Limited Liability Company (Verlag CH Beck 2006) 35–6.
[143] Section 823(1) BGB.
[144] See discussion in Bachner (n 119) 184–5.

organisational duties.[145] Importantly, if the company enters insolvency, a claim in respect of internal liability may be pursued by the insolvency office holder against a director; however, in the case of external liability, a claim may be pursued directly by a creditor even during the insolvency proceedings of the company.[146]

Under Section 823(2) of the BGB, tort liability also applies to a person who commits a breach of a statute that is intended to protect another person, subject to a requirement of fault. Importantly for the present discussion, depending on the scope of the protective statutory provision, this potentially includes pure economic loss, a concept omitted from Section 823(1). Perhaps the most important protective statutory provisions, from the point of view of non-adjusting creditors of a company in financial difficulties, are Section 15a of the InsO and Section 64 of the GmbH Act.

Under Section 15a of the InsO, the board of directors must file for insolvency when a company becomes cash-flow or balance-sheet insolvent within three weeks, during which time directors may take steps to avoid the opening of insolvency proceedings provided that there is a reasonable expectation that the state of insolvency will be brought to an end before the expiry of the three-week period.[147] A failure to file constitutes a criminal offence.[148] The German courts have long recognised this provision[149] as a protective norm for the purpose of Section 823(2) BGB.[150] Directors who breach this provision may be liable to pay compensation including, as will usually be the case, for pure economic loss.

Under Section 64 GmbH Act, directors are liable to compensate the company for payments made after it is cash-flow or balance-sheet insolvent unless the payments are made in compliance with the prudent businessman standard. This is a separate duty to that in Section 15a InsO, and the three-week period does not apply. Although the provision states that directors are liable to compensate the company, the courts have held that this is a liability owed to the creditors as a whole who may be disadvantaged by the reduction of assets even where the company suffers no loss,

[145] BGH, Judgment of 5 December 1989 (BGHZ 109) 297.
[146] Bachner (n 119) 186–7.
[147] ibid 188–9.
[148] Section 15a(4)-(5) InsO
[149] Including its predecessor in Section 64 para 1 GmbH Act.
[150] RG, Judgment of 5 June 1935 (JW 1935) 3301; Bachner (n 119) 189.

such as in the case of preferential payments.[151] Thus there is an overlap between the law relating to challenging transactions and direct liability of directors: an insolvency office holder can pursue either, although not recover twice; a director who has had to pay compensation may be able to seek recourse by demanding assignment of a claim for recovery against the recipient of the challengeable transaction.[152]

4.5.4 Enforcement of directors' duties

Regarding private enforcement, a director who breaches the general duties can be held liable by the company to pay damages, and directors have joint and several liability,[153] provided that each director meets the respective requirements for liability, for example either through a joint act resulting in breach or through failing to discharge a duty to supervise managers.[154] The company's claim for damages is generally made via ordinary resolution in the shareholders' meeting, but it can also be brought by an insolvency office holder or a creditor who, in the enforcement of claims against the company, has had the claim attached and transferred to her by court decision.[155] However, to maintain the *pari passu* rule, no such execution by an individual creditor would be permitted during insolvency proceedings.[156]

Regarding public enforcement, there is no separate Act that deals with the disqualification of directors; the matter is primarily dealt with by the GmbH Act. Section 6 determines the circumstances in which individuals are barred from being appointed as company directors. These include where an individual has received an occupational ban from the court or from an administrative body, and a list of automatic disqualifications resulting from committing one of the specified criminal offences. These will now be discussed in turn.

First, the criminal courts can ban an individual from a profession by issuing an order for professional disqualification if a person has been convicted of an unlawful act committed in abuse of their profession or trade and there is a danger that

[151] BGH, Judgment of 18 March 1974 (NJW 1974) 1088.
[152] Bachner (n 119) 192–3.
[153] Section 43 para 1, 4 GmbH Act.
[154] Schulz and Wasmeier (n 126) 102.
[155] Müller (n 142) 36.
[156] Bachner (n 119) 186.

they will commit serious unlawful acts of the same kind.[157] The courts have discretion as to whether to make such an order: the offender must have consciously and wilfully abused the opportunities provided by the profession, and the consideration of the court must be the protection of the general public.[158] The director must have committed the unlawful act *as* a director.[159] Given the fact that the ban restricts the individual's constitutional right to freedom of occupation, the offence must be sufficiently serious.[160] The court's ban is generally between 1-5 years, although there is an option for a lifetime ban in exceptional circumstances.[161]

Second, administrative authorities can ban someone from commercial activities if they are unreliable.[162] Here, this means that the individual concerned is unlikely to operate their trade adequately in the future.[163] Relevant acts include criminal insolvency offences, offences against property and assets, excessive debts or significant tax debts.[164] It is also required that the ban be 'necessary', which means that it cannot be ruled out that the individual will continue their unreliable conduct in the future.[165] If the relevant administrative body makes a prohibition order, it will continue in effect until the body permits the individual to resume their work as a company director.

Thirdly, Section 6(3) GmbH Act includes a list of criminal offences, conviction for which carries with it an automatic 5-year ban. This includes delay in filing for insolvency, mentioned above, as well as other offences in relation to conduct in insolvency, and several offences connected to fraud.[166] However, only wilful or intentional acts are included and, in relation to the latter fraud-related offences, a penalty of at least one year in prison is required for disqualification.[167]

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[157] Section 70(1) Criminal Code ("StGB").
[158] Rühmkorf (n 127) 192.
[159] ibid.
[160] T Fischer, *Strafgesetzbuch mit Nebengesetzen* (61st edn, CH Beck Verlag 2014) s 70 [9] (German language).
[161] Section 70(1)2 StGB.
[162] Section 70 StGB; Section 35 GewO (Trade Regulations).
[163] Rühmkorf (n 127) 192.
[164] H Hirte, T Lanzius and S Mock, 'Tätigkeitsverbote für Organmitglieder als Gläubigerschutzinstrument' in M Lutter (ed.), Das Kapital der Aktiengesellschaft in Europa (De Gruyter, 2006) 307 (German language).
[165] Section 35(1) GewO (Trade Regulations).
[166] Section 6(2)3(c)-(e) GmbH Act.
[167] Section 6(3)(e) GmbH Act.

Where one of these grounds arises after a director has been appointed, the appointment automatically ends.[168]

4.6 Comparative analysis and evaluation

This section compares the approach of each jurisdiction in relation to general directors' duties, directors' duties to creditors when the company is in financial difficulties, and enforcement of directors' duties respectively. The final part of this section evaluates the approach of Thai law against the principles of creditor protection based on an ESV approach to corporate governance as discussed in Chapter 1.

4.6.1 Comparative Analysis

Regarding the general duties of directors while the company is solvent, the three jurisdictions differ in the extent to which the interests of creditors, and specifically non-adjusting creditors are recognised. The prevailing view in Thai law appears to be that directors only need consider shareholders' interests. However, the wording of Section 1169 paragraph 2 of the CCC, taken together with related Supreme Court decisions, suggests the potential for Thai law to be interpreted to require directors to take account creditors' interests where their decisions may result in the company's inability to pay its debts. However, it is noteworthy that these provisions have not apparently received this interpretation by academics or the courts. English law, by contrast, has consciously adopted an ESV approach in its codification of directors' duties under Sections 171-177 of the CA 2006. Creditors are not mentioned specifically in the list of interests which must be taken into account, although suppliers and customers, two important categories of non-adjusting creditors, are included. Rather, pursuant to Section 172(3), creditors' interests appear to rise to the fore only where a company encounters financial difficulties, as discussed below. Finally, German law is interpreted to include creditors directly within the constituencies whose interests make up the interests of the company; their interests should be always taken into account in the same way as those of shareholders.

[168] Rühmkorf (n 127) 184.

However, directors are bound to follow instructions given by the shareholders' meeting, which potentially puts shareholders in a privileged position in relation to the decision-making process of directors. Nevertheless, it should be noted that while a company is solvent, fully able to repay its debts, the requirement to take into account creditors' interest is perhaps predominantly an academic or theoretical question. This changes when a company is in financial difficulty.

Regarding directors' duties to preserve creditors' interests in financial difficulties, there are marked differences between the three jurisdictions. In Thai law, there is no recognised shift of directors' duties. A director will not be considered to commit a wrongful act if the company fails to make a repayment under a contract, for example, unless the director knew at the time of making the contract that the company could not pay. Furthermore, an insolvent company cannot initiate liquidation bankruptcy proceedings, and there is no requirement for directors to put a failing company into business reorganisation proceedings, where these are available. Instead, Thai law relies on criminal provisions to deter and punish misbehaviour by directors. The Offences Act contains general prohibitions on transferring assets away from the company to avoid creditors' claims and on obtaining benefits by causing loss to the company. The BA also confers a range of criminal offences for misbehaviour in the one-year period prior to bankruptcy, including dishonestly dissipating the company's assets, failing to give reasons for large losses or creating debts without any cause to believe that they will be paid. By contrast, English law recognises a shift in directors' duties when it is probable that the company will become insolvent. However, in addition to this, the concepts of fraudulent trading and wrongful trading confer potential criminal and civil liability on directors, encouraging them to file for bankruptcy where there is no realistic prospect of recovery of the business. German law recognises a direct tortious liability owed by directors to creditors both as a result of a breach of their organisational duties and as a result of a breach of their statutory duty to file for insolvency within three weeks of the company becoming cash-flow or balance-sheet insolvent, under Section 15a InsO. A failure to file also constitutes a criminal offence. Furthermore, the directors owe a separate liability to compensate the company for payments made after it is cash-flow or balance-sheet insolvent, without the three-week grace period, under Section 64 GmbH Act. This results in a legal

framework which strongly incentivises directors to file for bankruptcy immediately upon factual insolvency, in contrast to English law where insolvent companies may trade for some time, provided the directors are conscious of the risks of wrongful trading, or Thai law under which directors cannot file for bankruptcy.

Regarding enforcement of directors' duties, all three jurisdictions allow for both private and public enforcement; however, the framework for each is once again significantly different. Thai law permits creditors to bring private enforcement actions directly against directors for breach of general duties. However, the practical issues with pursuing a claim discussed above make this a weak form of protection for non-adjusting creditors. Instead, Thai law relies more heavily on public enforcement under the criminal provisions, including by the insolvency office holder who is empowered to be an enquiry official under the Criminal Procedure Code. However, this enforcement is restricted to the scope of the specific offences and by the requirements of proof to the criminal standard, as discussed above. Furthermore, there is no mechanism by which misbehaving directors may be disqualified from acting as directors in the future. By contrast, English law does not permit creditors to enforce directors' duties directly outside of insolvency; however, the insolvency office holder can bring proceedings in the name of the company for a breach of directors' duties on creditors' behalf, subject to a defence of acting honestly and reasonably under Section 1157 of the CA 2006. The insolvency office holder can also bring claims for fraudulent trading and wrongful trading, which may incur both criminal and civil liability as discussed above. However, English law also has an extensive director disqualification regime under the CDDA, under which the Insolvency Service may apply to the court to disqualify a director of an insolvent company for acting in a manner that is unfit: essentially, displaying a lack of probity or competence. The standard is a civil one rather than criminal, and there is the option of an out-of-court procedure. In German law, the regime for private enforcement by creditors is more extensive, with creditors able to make claims directly against directors under tort law as discussed above, and enforce claims of the company against directors, subject to insolvency proceedings. In relation to public enforcement, there are a number of criminal offences in relation to both failing to file for insolvency and for conduct in insolvency. These may result in automatic director

disqualification. In addition, where directors have committed other criminal offences, the court may issue an order for disqualification, in notable contrast to Thai law where a very similar provision is not interpreted in this way. Finally, administrative authorities can also ban an individual from commercial activities if they are unreliable, which will disqualify them from acting as a director.

4.6.2 Evaluation of Thai law

As discussed above in the theoretical section of this chapter, under an ESV model of directors' duties, creditors' interests should be recognised at all times although the ultimate interest to promote is that of the shareholders in the long term. However, this changes when creditors become the residual claimants – i.e. when the company is factually insolvent or in financial difficulties from which it is unlikely to recover. At that point, the company should be run by the directors with the objective of serving creditors' interests in the long term. In addition, from the perspective of non-adjusting creditors, it appears that public enforcement and its deterrent effect on the activities of directors is likely to be more effective than private enforcement. Thai law, using the conclusions from the comparative analysis above, may be evaluated on this basis, addressing the first research question of this dissertation.

As discussed above, in relation to solvent companies, Section 1169 appears to recognise creditors' interests as relevant to the company and to directors' duties, albeit in an indirect way, which is indeed compatible with an ESV model. It is notable, however, that this does not appear to be the manner in which directors' duties are generally framed in academic literature; as discussed above, it seems generally recognised that directors only need consider the interests of shareholders. However, more important from the perspective of the protection of non-adjusting creditors is the position when a company is in financial difficulties.

When a company encounters financial difficulties, the law provides for no change in the nature of directors' duties and responsibilities. Indeed, Thai bankruptcy law does not permit a failing company to petition for bankruptcy: this is a mechanism reserved only for creditors to initiate. There is no equivalent concept to fraudulent or wrongful trading in English law or Section 15a of the InsO in German

law, both of which potentially impose criminal penalties and the requirement for directors to compensate the company. Nor is there, as in the case of German law, direct liability between directors and creditors on a tortious basis, for failure to put the company into formal insolvency proceedings. In addition, although Thai law does contain a number of criminal offences designed to ensure that directors are not acting abusively in the period prior to bankruptcy, there is no effective regime to disqualify misbehaving directors from acting as directors for companies in the future.

Thus, the theoretical discussion and comparative analysis performed here exposes significant weaknesses in Thai law, when evaluated from an ESV perspective. Specifically, it lacks an effective means of ensuring that directors make decisions in the interests of the company's creditors when a company is in financial difficulties, as required by the ESV model of corporate governance. The historical discussion highlights the fact that Thai law did not develop a shift in directors' duties nor a direct tortious relationship between directors and creditors, as in English law and German law respectively. In addition, Thai bankruptcy law has not incorporated a requirement on company directors to petition quickly, or at all, for a formal insolvency process designed to protect creditors' interests. Furthermore, Thai law has not developed a mechanism for director disqualification, either through interpretation of professional prohibitions in criminal law, as in German law, or through specific legislation as in English law. However, Thai law clearly relies on public enforcement, via the criminal provisions under the Offences Act and the BA, under which the insolvency office holder may take action.

On this basis, recommendations may be made for recognition of directors' duties to consider creditors' interests in financial difficulties, and for public enforcement of these duties including a director disqualification regime, the details of which are set out in Chapter 6. Developing an extensive regime for private enforcement is not recommended. As discussed above, in practice this offers little protection for non-adjusting creditors; furthermore, Thai law has not developed this in nearly a century since the CCC has been in effect, even though similar legislative provisions in Germany, for example, have been interpreted to permit direct private enforcement through tort law. Rather, Thai law at present relies on public enforcement through criminal law, and therefore it is recommended that this approach

be further developed for better protection of non-adjusting creditors in accordance with ESV principles.

4.7 Conclusion

This chapter has addressed this dissertation's two initial research questions, of whether non-adjusting creditors are sufficiently protected, and how the law relating to their protection has developed, in relation to directors' duties. From the theoretical discussion performed in the first part of this chapter, from an ESV perspective, the interests of creditors are included in the interests of stakeholders which must be taken into account at all times by directors when making decisions. However, since the ultimate objective is to maximise shareholders' interests in the long term, where a company is fully solvent and able to pay its debts, creditors' interests appear to be fully satisfied while there is no likely prospect of this position changing. However, where a company encounters financial difficulties and faces a real likelihood of not being able to escape insolvency, directors' duties change. Creditors become residual claimants, in whose interests directors must run the company. In addition, due to the circumstances facing failing companies and their non-adjusting creditors, public enforcement of these duties appears more effective for protection of non-adjusting creditors.

In relation to the second research question, the historical analysis of Thai law reveals that although influenced by foreign sources, including contemporary English and German law, the framework of Thai law differs particularly in its emphasis, even at the time of its adoption, on public enforcement of standards of directors' conduct via the criminal law. English and German law revised their law throughout the twentieth century generally in the direction of increasing creditor protection, including through mechanisms requiring directors to file for formal insolvency processes, legislative changes to directors' duties, judicially developed shifts in directors' duties and a direct tortious relationship between directors and creditors. In addition, both English and German law have developed a legal framework to disqualify misbehaving directors. Thai law has not developed any of these creditor-protective mechanisms in respect of directors' duties.

In relation to the first question, the evaluation of Thai law in relation to an ESV model of corporate governance reveals significant incompatibilities in relation to the protection of creditors' interests when a company is in financial difficulties. Specifically, there is no recognised shift in directors' duties or recognition that directors must act in creditors' interests as the residual claimants. Instead, this concept is covered through specific criminal provisions in the Offences Act and the BA, which operate to penalise and deter directors. This analysis leads to a number of recommendations which can be made, in accordance with the third research question of this dissertation, to bring Thai law into closer alignment with an ESV model of corporate governance, as detailed in Chapter 6. Moreover, in accordance with the second research question, the analysis reveals that Thai law has relied on public enforcement and has not developed a significant private enforcement regime. Therefore, the recommendations will be focused in this direction also, in order to be compatible to the fullest extent possible with the existing regime. The final area of legal rules for the protection of non-adjusting creditors is shareholder liability, to which the next chapter of this dissertation turns.

CHAPTER 5
SHAREHOLDER LIABILITY

5.1 Introduction

This chapter examines the fourth category of rules which offer protection to non-adjusting creditors: liability of shareholders for debts owed by the company. As discussed further in this chapter, these mechanisms essentially disregard one or both of two fundamental concepts of company law, the separate personality of the limited company and the limited liability of its shareholders. To assist in the comparative exercise performed in this chapter, shareholder liability is divided into two broad concepts. The first is piercing the corporate veil, which covers legal mechanisms permitting courts to disregard the separate personality of the company and thereby nullify the limited liability of its shareholders. This results in direct liability of shareholders for the debts of the company. The second concept covers legal mechanisms which confer liability on shareholders due to the level of control that they exercise over the company's business. This may result in direct liability between shareholders and creditors, for example, if the law considers that controlling shareholders owe them duties. Alternatively, this may result in liability between the shareholder and the company itself, if the interference of shareholders in the business of the company results in its failure, for example.

In a similar manner to the previous chapters, this chapter will address the two initial research questions of, first, whether non-adjusting creditors of private limited companies are sufficiently protected by the law relating to shareholder liability in Thailand, and, second, how the law relating to shareholder liability has evolved in all three comparator jurisdictions. In relation to the first question, an ESV model of corporate governance will be used as a yardstick to evaluate the Thai legal regime. In relation to the second research question, a comparative analysis focusing on the development of Thai law will be used in order to allow the formation of nuanced recommendations for the improvement of Thai law in this area, in accordance with the third research question of this dissertation.

This chapter will proceed as follows. The first section will discuss the concepts underlying shareholder liability and the role it plays in the protection of non-adjusting creditors. The second, third and fourth sections will examine the rules relating to shareholder liability in the three comparator jurisdictions, with the discussion divided into an examination of the historical development, and then an analysis of the current concepts of piercing the corporate veil and liability based on control of the company respectively. The fifth section provides a comparative analysis of the three jurisdictions' approaches to this concept and an evaluation of the approach of Thai law, directly addressing the two initial research questions of this dissertation. The final section concludes.

5.2 Shareholder liability and creditor protection

The conceptual basis of shareholder liability is closely tied to the concepts of the separate personality of the company and the limited liability of its shareholders. The general rule is that the debts of the company are separate from the debts of the shareholders, and once shareholders have paid up the amount agreed for share subscriptions in full, they bear no further liability in respect of their investment in the company.[1] For creditors to bring a claim against the shareholders for debts owed to them by the company, the law must provide an exception to these concepts or allocate liability on another basis, for example by recognising a relationship in tort between the shareholders and creditors.[2] This section will briefly discuss relevant academic criticism that has been made of limited liability and separate personality from a normative perspective, before making some general comments about the doctrinal basis of veil piercing and its interaction with other legal concepts and liability based on control of the company. This section concludes with a brief analysis of shareholder liability from an ESV perspective.

The concept and benefits of asset partitioning have been discussed in Chapter 1, along with the associated risks that are created to creditors, especially non-

[1] Paul Davies, *Introduction to Company Law* (2nd edn, Oxford University Press 2010) ch 3; Lowry John and Arad Reisberg, *Pettet's Company Law: Company Law and Corporate Finance* (4th edn, Pearson Education 2012) 40–1.
[2] John and Reisberg (n 1) 37–9.

adjusting creditors, through asset dilution, asset substitution and debt dilution. Asset partitioning, as discussed, arises from two concepts considered fundamental to the corporate form, the separate personality of the company and limited liability of shareholders. However, as discussed below, all three comparator jurisdictions allow veil piercing to some extent, which may be defined as judicial disregard of the asset partitioning functions of separate legal personality and limited liability.[3] Essentially, this concerns the reallocation of liability between shareholders and creditors in, as Easterbrook and Fischel argue,[4] an attempt to balance the benefits of limited liability against its costs, although other commentators have noted that judicial reasoning in this area does not generally seem to closely reflect this balancing exercise.[5]

The benefits of separate personality and limited liability for the economy generally have been briefly discussed in Chapter 1 and need not be further discussed here. Instead, this section, before discussing the doctrinal basis of veil piercing, will focus on the claims that have been made by scholars in support of the concept of veil piercing from a normative perspective. These claims may be separated into three groups: private companies, involuntary creditors, and corporate groups.

First, in relation to private companies, many of the benefits of limited liability do not apply in the same way, or to the same extent, as they do in relation to public companies.[6] Typically, in private companies there is an overlap or very close connection between shareholders and managers, and therefore limited liability does not reduce shareholders' monitoring costs. Furthermore, since shares in private companies are not freely transferable in the same way as those of listed public companies, limited liability does not facilitate efficient risk bearing or investor diversification to the same extent.[7] Indeed, it has been argued that some form of unlimited liability in relation to contract creditors of private companies would be suitable to address incentives operating on shareholder-managers to transfer

[3] Mohamed F Khimji and Christopher C Nicholls, 'Corporate Veil Piercing and Allocation of Liability: Diagnosis and Prognosis' (2015) 30 Banking and Finance Law Review 211, 214.
[4] Frank H Easterbrook and Daniel R Fischel, 'Limited Liability and the Corporation' (1985) 52 University of Chicago Law Review 89, 109.
[5] David Milton, 'Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability' (2006) 56 Emory Law Journal 1305, 1326.
[6] Easterbrook and Fischel (n 4) 110.
[7] ibid.

uncompensated business risks to creditors.[8] However, it has also been argued that asset partitioning makes financing private companies more efficient, through reducing creditors' monitoring costs and allowing entrepreneurs to select which business assets to expose to the risks of running a business.[9] Indeed, commentators have argued that limited liability may be accepted as a default rule which voluntary creditors may be able to bargain around depending on their individual circumstances.[10]

However, in the case of involuntary creditors, stronger criticism has been levelled at the benefits of limited liability. In respect of tort victims, Hansmann and Kraakman argue that limited liability incentivises externalisation of accident costs without apparently serving any efficiency enhancing purpose, since involuntary creditors cannot bargain in advance in relation to the risks.[11] As discussed in Chapter 1, this logic extends beyond tort victims to include other groups of involuntary creditors and non-adjusting voluntary creditors. Instead of a rule of limited liability, Hansmann and Kraakman propose proportionate liability for shareholders in the case of torts which result in the failure of the corporation, to force investors to internalise the risks incurred by corporations in which they invest.[12] However, other scholars have contested this proposal on the basis that the costs would be prohibitively high and would, despite Hansmann and Kraakman's claims, lead to less investment.[13] Although few scholars appear to advocate for the total abolition of limited liability in respect of tort claims, several suggest that courts should pierce the corporate veil more often in this context in order to incentivise shareholders to externalise tort risk, for example through the use of insurance products.[14]

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[8] Paul Halpern, Michael Trebilcock and Stuart Turnbull, 'An Economic Analysis of Limited Liability in Corporation Law' (1980) 30 University of Toronto Law Journal 117, 126.
[9] Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017) 9.
[10] Halpern, Trebilcock and Turnbull (n 8) 126; Stephen M Bainbridge, 'Abolishing Veil Piercing' (2000) 26 Journal of Corporate Law 479, 507–8.
[11] Henry Hansmann and Reinier Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) Yale Law Journal 1879, 1920.
[12] ibid 1892–4. Also, see Nina A Mendelson, 'A Control-Based Approach to Shareholder Liability for Corporate Torts' (2002) 102 Columbia Law Review 1203.
[13] Bainbridge (n 10) 497–8; David W Leebron, 'Limited Liability, Tort Victims, and Creditors' (1991) 91 Columbia Law Review 1565, 1601.
[14] Halpern, Trebilcock and Turnbull (n 8) 145–7; Easterbrook and Fischel (n 4) 109–10; Bainbridge (n 10) 505–7.

In relation to groups of companies, it has been argued that considerations justifying limited liability are less persuasive when applied to corporate shareholders and sister companies than when applied to individual shareholders.[15] For example, it has been argued that economic justifications such as facilitating diversification are less relevant, while limited liability within corporate groups allows using undercapitalised entities to carry out business activities, effectively denying the enforcement of judgments against them.[16] As a result, theorists have argued for extending liability to other members of corporate groups, based on the concept of enterprise liability,[17] the normative responsibilities of control[18] or the capacity to exercise control,[19] and collective responsibility based on participatory intentions.[20]

From the perspective of the doctrinal basis of veil piercing, this will be discussed in more detail below in relation to each jurisdiction. However, some general points should be made at this stage. First, in many jurisdictions, legislation contains express exceptions to the concepts of separate personality or limited liability, in relation to taxation or to consider the nationality of the shareholders, for example.[21] This demonstrates that separate personality and limited liability are not absolute concepts and may bow to other considerations. In addition, in all three comparator jurisdictions as discussed below, the courts have gone beyond these specific exceptions to ignore separate personality and impose liability on a company's shareholders, although it appears that they do so rarely. In general, and subject to details which will be discussed below, courts will only pierce the corporate veil to prevent the abuse of corporate legal personality in some specific manner.

However, potential conflicts between the concept of piercing the corporate veil and other areas of law must be considered. For example, where a

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[15] Bainbridge (n 10) 528; Leebron (n 13) 1619.
[16] Bainbridge (n 10) 529; Lynn M LoPucki, 'The Death of Liability' (1996) 106 Yale Law Journal 1.
[17] Adolf A Berle, 'The Theory of Enterprise Entity' (1947) 47 Columbia Law Review 343; Phillip I Blumberg, 'The Transformation of Modern Corporation Law: The Law of Corporate Groups' (2004) 37 Connecticut Law Review 605; Meredith Dearborn, 'Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups' (2009) 97 California Law Review 195.
[18] Irit Mevorach, Insolvency within Multinational Enterprise Groups (Oxford University Press 2009); Andrew Muscat, The Liability of the Holding Company for the Debts of Its Insolvent Subsidiaries (Routledge 2016).
[19] Mendelson (n 12).
[20] Christopher Kutz, *Complicity: Ethics and Law for a Collective Age* (Cambridge University Press 2007).
[21] See for example in relation to Thai law the Acts discussed in Section 5.3.2 below.

shareholder engages in wrongdoing, she may incur liability directly towards her company which may later fall into formal insolvency proceedings. In this circumstance, allowing a creditor to claim directly against the shareholder through veil piercing comes into conflict with the insolvent company's claims, pursued for the benefit of the company's creditors as a whole.[22] In addition, there may be a relationship between a company and its controlling shareholder which allows other rules to be used as a recourse for creditors, relegating veil piercing to a residual doctrinal category operating in exceptional circumstances.[23]

Finally, as discussed in Chapter 1, particularly in the case of private companies it may be the case that there is an overlap or close connection between the shareholders, or a subset of them, and the directors of the company. Indeed, it may be the case that a controlling shareholder of a private company in practice exerts significant influence over the decisions made by the board of directors. In such a situation, as discussed below, jurisdictions may impose duties and liabilities on shareholders based on their control of the company, extending the duties and responsibilities usually imposed on the board to the person who, in practice, is the decision-maker. In addition, jurisdictions may hold shareholders liable in tort for the consequences of decisions they make or influence where, for example, these result in the failure of the business, damaging the company and, by extension, the creditors. The existence of such liability can protect non-adjusting creditors through addressing adverse incentives of such shareholders.

An ESV perspective of the corporate objective supports rules that disincentivise abusive behaviour on the part of a company's controllers which prioritise the interests of shareholders over non-adjusting creditors. Therefore, it is compatible with concepts that provide a remedy to creditors and act as a deterrent to shareholders in the case of the abuse of separate personality and limited liability to prejudice creditors' claims. In addition, the ESV perspective supports disincentivising abusive behaviour by those in effective control of a company, not just directors, which can play an important part in protection of non-adjusting creditors. This is

[22] Tan Cheng-Han, Jiangyu Wang and Christian Hofmann, 'Piercing the Corporate Veil: Historical, Theoretical and Comparative Perspectives' (2019) 16 Berkeley Business Law Journal 140, 154.
[23] ibid 155.

particularly in situations where creditors have become the company's residual claimants as discussed in Chapter 4, when company controllers should consider creditors' interests in company decision-making. This chapter will now discuss the relevant rules in relation to each jurisdiction, divided, after analysis of the historical background and development, into a discussion of piercing the corporate veil and shareholder liability based on control of the company.

5.3 Shareholder liability in Thai law

The general position on shareholder liability in Thai law is that, when a company is registered, it is a legal person separate from its shareholders[24] and the liability of shareholders is limited to the amount, if any, unpaid on the shares that they hold.[25] However, there are certain circumstances in which these concepts are disregarded. In Thai law, the legal mechanisms may be divided into three categories: specific statutory exceptions, the judicially developed concept of piercing the corporate veil, and the mechanism under Section 44 CCPA. However, unlike English and German law as discussed below, beyond this Thai law has not developed a concept of shareholder liability based on control of the company. Before analysing the current position, the next section will discuss the historical background and development of the concept of shareholder liability in Thai law.

5.3.1 Historical background and developments

When the first chartered companies were founded in Siam, starting in the year 1888, the relationship created between those establishing the company and the entity itself was unclear.[26] The purpose of creating charter companies was to give legal powers and status to project participants which would otherwise be denied to foreigners, including the ability to own property and to bring, and be subject to, cases in the Thai courts.[27] However, the instruments creating the first charter companies

[24] Section 1015 CCC.
[25] Section 1096 CCC.
[26] Thipchanok Ratthanosot, *Explanation of Legal Provisions and Principles Relating to Partnerships and Companies* (6th edn, Thammasat University 2013) 206–7 (Thai language).
[27] ibid 207.

were silent as to the question of whether liability of the participants was limited.[28] Consequently the Act Amending the Principles of Debt R.S. 110 (1891) was promulgated, referencing a recommendation made to the King by the Minister of Foreign Affairs that the contemporary legal provisions on debt were not effective when applied to groups of people doing business together, and caused hardship for honest traders whose businesses failed.[29] Section 2 of this Act created a regime of limited liability, by providing that shareholders who have announced publicly that their company is limited by shares and contributed capital for use in the company's trading have no further liability beyond the amount required to be contributed in respect of their shares.[30] The remaining five provisions of this short Act establish a corporate bankruptcy scheme, which provides protection for honest shareholders in the case of a failure of the company.[31] However, if the investigation of the bankrupt company revealed dishonest concealment of assets, a case could be brought against shareholders personally.[32] The founding instruments of charter companies from the early 20th century also seem to have generally contained references to the limited liability of the shareholders.[33]

Following general incorporation, the concept of limited liability was provided for explicitly in Section 87 of the Partnerships and Companies Act of 1911 and, following adoption of Book III of the CCC, in Section 1096 thereof. Although the Book of Revised Drafts contains a wide variety of foreign sources for Section 1096, the wording is most similar to the equivalent provision in the Japanese Commercial Code, although structurally and conceptually this provision appears also strikingly similar to Section 87 of the Partnerships and Companies Act of 1911.[34]

There is no stated exception to the principle of limited liability in the company law part of the CCC. However, there are instances in which the law allows either for the separate personality of the company to be disregarded, or for the

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[28] ibid.
[29] Act Amending the Principles of Debt R.S. 110 (1891), Government Gazette Vol 8, Ch 50, p.445-7, announced 6 March 1891, see preamble (Thai language).
[30] Ibid, Section 2.
[31] Ibid, Section 6.
[32] Ibid, Section 7; see also Faculty of Law, Thammasat University (Prof. Sahaton Ratthanapaijitr et. al.), 'Research Report Concerning Project to Improve the Enforcement of Bankruptcy Cases in accordance with International Standards' 8–9 (Thai language).
[33] Ratthanosot (n 26) 208.
[34] See the table analysing the sources of the provisions included at Annex 2 to this dissertation.

principle of limited liability to be overridden. These may be separated into three conceptual categories, the detail of which will be discussed in the next section: specific statutory exceptions; the judicially developed doctrine of piercing the corporate veil; and Section 44 of the CCPA. The former two categories will be discussed below and need no historical introduction here. However, the background to the CCPA will be discussed.

From the legislative note appended to the CCPA, the reasons for passing the Act were to address problems of exploitation of consumers by business operators, specifically through addressing barriers facing consumers in bringing successful claims for compensation including lengthy and expensive procedures, overturning the burden of proof and gaining access to evidence.[35] With regard to shareholder liability, Section 44 of the CCPA provides a mechanism whereby the court may allow shareholders to be held liable for the debts of a company, as discussed further below. From the minutes of the drafting committee for the CCPA, it appears that the purpose of including this procedure was that Thai law did not specifically provide for exceptions to the principle of limited liability where a company has been used by shareholders as a puppet to defraud customers dealing with it.[36] As discussed below, such a mechanism has, according to some commentators, been developed by the courts, using Section 5 of the CCC. Section 44 of the CCPA may be seen as an attempt to put this mechanism on a statutory footing in the context of consumer cases, simultaneously clarifying matters such as the availability of the procedure, the burden of proof, and the consequences of the mechanism for shareholders.

Overall, therefore, this analysis reveals that the limited liability of shareholders has a long statutory history, enshrined in legislation since the late 19th century. However, throughout the intervening period there have been exceptions to the principle, either in legislation such as the Act Amending the Principles of Debt R.S. 110 (1891) and the CCPA or, arguably, developed by the courts as discussed below. The current legal position will now be discussed.

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[35] See legislative note at the end of the CCPA, Government Gazette, Vol 125, 38 gor, 51 on 25 February BE 2551 (2008).

[36] Minutes of the meeting of the Council of State concerning the drafting of the Consumer Cases Procedure Act no. 7/2550, 5 September BE 2550 (2007).

5.3.2 Piercing the corporate veil

As discussed above, mechanisms which allow the law either to disregard the separate personality of a limited company or to confer liability directly on shareholders for debts of the company may be separated into three categories: specific statutory exceptions, the judicially developed doctrine of piercing the corporate veil, and Section 44 of the CCPA. Regarding specific statutory exceptions, there are several situations in which the law disregards the separate legal personality of the company including, for example, in respect of the nationality of a company in wartime, or in respect of foreign shareholders of a company attempting to own land or shares in a financial institution, or for tax purposes.[37] However, none of these situations concern the protection of non-adjusting creditors, and therefore they need not be discussed further.

Regarding the judicially developed doctrine of piercing the corporate veil, there appears to be a divergence of views. Some of the core textbooks regarding company law do not refer to this mechanism at all, which suggests either that the authors do not accept that it exists as a concept in Thai law, or that it is such an unusual exception that it is not worthy even of mention.[38] By contrast, other academics have gathered together a number of Thai Supreme Court decisions, citing these as examples of piercing the corporate veil or disregarding separate legal personality, often by comparison with other jurisdictions.[39] However, a close examination of these decisions reveals that very few are clear examples of piercing

[37] Act Prohibiting Trading with the Enemy BE 2460, Act Allowing Detention and Control of Businesses or Property of Persons of Enemy Nationality BE 2488, Executive Order 281 of 25 November 2515 and Land Code Section 97, Act on Commercial Banks BE 2505 Section 5 bis, Revenue Code Section 75.

[38] These include Sahaton Rathanapaichitr, *Explanation of the Principles of Partnership and Company Law* (6th edn, Winyuchon Publication House 2020) (Thai language); Nontawach Nawathragulwisuth, *Legal Principles of Partnerships, Limited Companies and Public Limited Companies* (4th edn, Winyuchon Publication House 2019) (Thai language); Ratthanosot (n 26). See also Nitinantana Bruranajaroenraksa, 'Piercing the Corporate Veil to the Shareholder Liability' (2013) 2 Ramkhamhaeng University Law Journal 124 (Thai language).

[39] See e.g. Pithitul Jiramongkonpanich, Disregarding Separate Corporate Personality (Thammasat University 2013) (Thai language); Sophon Ratanakorn, Explanation of the Provisions of the Civil and Commercial Code relating to Partnerships and Companies (12th edn, Nitibannagarn 2010) 263–7 (Thai language); Praphrut Chatprapachai, 'Piercing the Corporate Veil Doctrine in Comparative View' (2013) 4 Assumption University Law Journal 37. See also Niwittachai Samnaopan, 'Liability of shareholders and directors of companies under the concept of disregarding the corporate personality of the company' (LLM Thesis, Faculty of Law, Thammasat University 1986) (Thai language).

the corporate veil. For example, Supreme Court decisions 3119/2526 and 1560/2527, which have similar facts, concern the taking of security by a company over the shares of another company in its corporate group.[40] The Supreme Court in both cases held this to be a violation of the prohibition on a company owning or taking security of its own shares, pursuant to Section 1143 of the CCC. However, rather than seeing this as piercing the corporate veil, this may instead be better viewed as simply an extension of the interpretation of Section 1143 to prohibit indirect ownership or security of a company's own shares via the shares of a group company. Indeed, from a maintenance of capital perspective, the economic effect is the same whether a company takes security over its own shares or over the shares in its parent company. Furthermore, in the published summary of the Supreme Court judgments, there is no mention of disregarding the separate personality of the companies involved. In addition, other cited example cases arguably use other legal mechanisms, such as vicarious liability,[41] or simply involve an agreement that shareholders will accept personal liability for a failure of a company to perform under a contract.[42]

However, there are a few clear examples of the Supreme Court piercing the corporate veil to prevent those concerned from using separate corporate personality to avoid pre-existing contractual obligations. In Supreme Court decision 3969/2529, the second defendant was the managing partner of a limited partnership (A) with which the claimant had made a hire purchase contract for vehicles. The second defendant established a new limited partnership (B) and liquidated A, transferring the business to B. The Supreme Court held that the claimant could enforce the contract it had made with A against B. In this case, the Supreme Court disregarded the separate personality of the two limited partnerships on the basis that the participants appeared to treat them as the same, thereby preventing the defendants from using the distinction to avoid contractual obligations.[43] Although this case

[40] Jiramongkonpanich (n 39) 54; Ratanakorn (n 39) 265–6.
[41] Supreme Court decision 174/2528, cited by Jiramongkonpanich (n 39) 55.
[42] Supreme Court decision 2466/2542, cited by ibid.
[43] A similar application can be found in Supreme Court decision 273/2529, which concerned an employee filing a suit against the wrong company, being unaware who was the correct employer. See discussion in Ratanakorn (n 39) 266.

concerned limited partnerships, in principle the reasoning would apply to limited companies.[44]

Academics supporting concept of piercing the corporate veil have suggested that the separate legal personality of the company may be disregarded by the courts through an application of Section 5 of the CCC, the general requirement to act in good faith,[45] in situations including '*alter ego*', when the company is acting only as a puppet of the shareholders through complete domination, and in situations of dishonesty or impropriety, such as using the company improperly to avoid provisions of law or contractual obligations.[46] However, the absence of Supreme Court cases clearly evidencing this mechanism at the very least implies that this is a very exceptional process, and the mixed academic treatment suggests that there is not complete acceptance of the use or nature of the concept in Thai law.

The final category of legal mechanisms for piercing the corporate veil is Section 44 of the CCPA. Under this provision, in a consumer case, if it appears that the company (i) was incorporated or has acted in bad faith, has behaved deceitfully towards consumers, or has embezzled property for someone's benefit, and (ii) has insufficient funds to satisfy the obligation to pay compensation in relation to the case, the court may summon the shareholders, persons who are able to control the operation of the company, or persons who received property from the company, and hold them jointly liable for the company's obligation. The person will be released from this obligation if she can prove her innocence or, in the case of a person receiving property from the company, that she received the property in good faith and for value. For a person receiving property from the company, liability is capped at the value of the property. This mechanism only applies to consumer cases, meaning, essentially, disputes between consumers and business operators in relation to goods and services or product liability cases.[47]

As such, this provides potentially a very important mechanism for the protection of consumers – one category of non-adjusting creditors – in the case of

[44] ibid.
[45] ibid 267.
[46] Jiramongkonpanich (n 39) 56.
[47] Section 3 CCPA. See also Consumer Protection Act BE 2522 (1979) and the Act on Liability for Unsafe Products BE 2551 (2008).

bad faith or deceitful behaviour by a company, especially given the reversal of the burden of proof on the shareholder or controller once bad faith, deceit, or embezzlement has been established. However, this mechanism only applies in consumer cases and does not apply to cases involving trade creditors, for example. Furthermore, there must be bad faith, deceit, or embezzlement; a mere breach of contract and an insolvent company, for example, are not sufficient to confer liability beyond the company.[48]

5.3.3 Liability based on control of the company

This section discusses liability conferred on shareholders on the basis of control of the company. In the area of corporate groups, Thai law may hold several entities jointly liable for the tortious acts committed by an employee of one of them, revealing an enterprise view of liability, as argued elsewhere by the author.[49] However, this will only provide assistance to non-adjusting creditors where they are victims of a tort committed by an employee of a company with insufficient funds to meet their claims: in certain circumstances, they may be able to claim compensation from other companies which benefit from the employee's performance of her duties.[50] Beyond this rather specific instance, however, Thai law has not generally developed a concept of shareholder liability on the basis of control of the company, unlike English and German law as discussed further below.

5.4 Shareholder liability in English law

This section discusses the approach to shareholder liability in English law. As discussed below, English law may confer liability on shareholders through two conceptual mechanisms. The first is piercing the corporate veil, which received attention of the Supreme Court in 2013, resulting in a decision which set the mechanism on a principled basis while at the same time clarifying its exceptional and

[48] See e.g. Supreme Court decision 5282/2562.
[49] Adam Reekie, 'The Liability of Employers for the Acts of their employees: A Comparative Analysis of Section 425 of the Thai Civil and Commercial Code and Vicarious Liability in English Tort Law' (2017) 7 Thammasat Business Law Journal 1.
[50] See Thai Supreme Court cases 650/2545, 1576/2506, 450/2516, and 4070/2533.

limited nature. More broadly, the approach of English law to shareholder liability has been through the concept of shadow directors, the second mechanism, which extends directors' duties, liability for wrongful and fraudulent trading, and the director disqualification regime to those in accordance with whose instructions the directors of a company are accustomed to act. This extends the English approach to director liability, discussed in Chapter 4, to shareholders where they exert sufficient influence over the directors of the company. Therefore, this is potentially an important part of the creditor protection framework in English law.

5.4.1 Historical background and developments

The principle of separate corporate personality, supplementing limited liability which had been introduced by statute in 1855[51] as discussed in Chapter 2, was settled in English law by the famous case of *Salomon v Salomon & Co*.[52] In this case, the House of Lords affirmed the principle that a company is a separate entity from its shareholders, even where one shareholder fully controls the company, and the company is not to be regarded as the shareholder's agent.[53] The case also confirmed that the principle of limited liability applies in such a situation.[54] Over the century since the Salomon case, these concepts have repeatedly come under scrutiny and narrow exceptions have been developed. These may be divided into the judicially developed concept of piercing the corporate veil and specific statutory exceptions, which will be discussed in turn.

Perhaps the most robust approach to piercing the corporate veil was by Lord Denning MR in the case of *DHN Ltd v Tower Hamlets,*[55] who allowed the corporate veil to be pierced in a corporate group by drawing an analogy with a partnership, where each of the group companies was a partner and therefore to be treated as one concern. Soon afterwards, in *Woolfson v Strathclyde Regional Council,*[56] the House of Lords criticised this approach, taking a very narrow view of

[51] Limited Liability Act 1855.
[52] [1897] AC 22.
[53] For famous criticism of the decision, see Otto Kahn-Freund, 'Some Reflections on Company Law Reform' (1944) 7 The Modern Law Review 54.
[54] John and Reisberg (n 1) 33.
[55] [1976] 1 WLR 852.
[56] (1978) SC 90.

the application of the concept, limiting it only to special circumstances indicating that the company is a mere façade concealing the true facts. This remained perhaps the most influential case until, in 1990, the Court of Appeal case of *Adams v Cape Industries PLC*,[57] in which the court held that, apart from cases turning on the wording of particular statutes, the court could only pierce the corporate veil in cases where the company was being used for a deliberately dishonest purpose.[58] Specifically, the court denied the ability to pierce the veil merely because the principles of justice require it.[59]

Adams v Cape Industries remained the leading case on piercing the corporate veil until the 2013 Supreme Court case of *Prest v Petrodel Resources*.[60] As discussed below, in this case Lord Sumption limited the application to the 'evasion principle': using the separate legal personality of a company to escape an existing legal obligation, liability or restriction.[61] The court also stated that the mechanism should only be used as a last resort, and would generally not be necessary since frequently a legal relationship exists between a company and its controller.[62] Therefore, piercing the corporate veil is regarded as now constituting only a small residue of cases where abuse can only be addressed by disregarding separate personality.[63]

Regarding specific statutory exceptions, similarly to Thai law, a number have built up over time, but generally these do not impose liability on shareholders – they confer nationality, provide for creation of consolidated group accounts, etc – and therefore do not have a creditor protection function.[64] However, the risks posed to non-adjusting and unsecured creditors, particularly in the context of corporate groups through unfair risk allocation via undercapitalisation and intra-group

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[57] [1990] Ch 433
[58] Ibid, 539-40
[59] Ibid, 536. See also *Trustor AB v Smallbone (No 2)* [2001] 1 WLR 1177
[60] [2013] UKSC 34
[61] Per Lord Sumption: "when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control." Ibid, 35.
[62] ibid.
[63] ibid.
[64] P Davies and S Worthington, *Gower's Principles of Modern Company Law* (10th edn, Sweet & Maxwell 2016) 198–9.

loans and asset transfers, were extensively considered by the Cork Report.[65] The Committee found that the existing law, in particular with regard to situations where a parent company provides capital to a wholly-owned subsidiary through a secured loan, thus acquiring priority over unsecured creditors in the subsidiary's insolvency, was 'undoubtedly defective' and 'seriously inadequate'.[66] Cork, drawing on the US approach of equitable subordination, recommended subordination of intra-group liabilities which represent long-term capital of the company.[67] However, the recommendations were not adopted. Instead, the preferred approach of the legislature was to explicitly extend concepts of directors' duties, director disqualification, and wrongful trading to 'shadow directors.'

Although the term shadow director was first used in a statute in 1980,[68] the concept can be traced back to the Companies (Particulars as to Directors) Act 1917.[69] As discussed further below, the general purpose of shadow director provisions in company and insolvency legislation is to discourage persons who are not directors from exerting influence over the decisions of the regular directors. Shadow directors do not have the powers of properly appointed, *de jure* directors. However, liability may be conferred on them for breaches of a variety of directors' duties, which have gradually increased over time, particularly with the extension to them of liability for wrongful trading, demonstrating an increased reliance of English law on this concept.[70] This section will now discuss the current English law on shareholder liability, dividing the discussion between piercing the corporate veil and liability based on control of the company which, for English law, will concentrate on the concept of shadow directors.

5.4.2 Piercing the corporate veil

[65] Kenneth Cork, 'Report of the Review Committee on Insolvency Law and Practice' (1982) Cmnd 8558 1924–50.
[66] ibid 1934 and 1950 respectively.
[67] Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (2nd edn, Cambridge University Press 2009) 586.
[68] Section 63 of the Companies Act 1980.
[69] Section 3 Companies (Particulars as to Directors) Act 1917.
[70] Chris Noonan and Susan Watson, 'The Nature of Shadow Directorship: Ad Hoc Statutory Intervention or Core Company Law Principle' (2006) Journal of Business Law 763, 766–8.

As discussed above, English law on piercing the corporate veil now centres on the Supreme Court case of *Prest v Petrodel Resources*, its first direct treatment by the highest appellate body in the jurisdiction since the seminal *Salomon* case. The decision has been welcomed by some commentators as a principled approach to an area which had previously been criticised for its incoherence by judges and academics.[71] However, the decision has been criticised by others for the limited concurrence by the members of the court on the fundamental questions of precisely what is meant by piercing and when it should be permissible.[72]

In *Prest v Petrodel,* Lord Sumption, giving the leading judgment, recognised that a limited power to pierce the corporate veil in carefully defined circumstances is necessary if the law is "not to be disarmed in the face of abuse."[73] Abandoning references to 'façade' and 'sham' which had been present in previous case law, he identified two principles from the authorities: the concealment principle and the evasion principle. The concealment principle concerns interposition of companies to conceal the identity of the real actors. This should not deter courts from looking behind the arrangements to understand what is really going on, but this does not constitute piercing the veil. By contrast, the evasion principle is the true nature of piercing the corporate veil – where a company is interposed so that its separate legal personality will defeat the enforcement of a legal right against the person in control of it which exists independently from the company.[74] Examples of previous cases used by His Lordship were *Gilford Motor Co Ltd v Horne*[75] and *Jones v Lipman*:[76] the defendant in the former established a company with his wife as shareholder to avoid a non-compete obligation in a contract with a previous employer; the defendant in the latter sold property purchased from the plaintiff to a company he owned and controlled to avoid the plaintiff's claim for specific performance. However, the principle is a limited one because the veil should not be pierced unless it is necessary to do so: if other legal mechanisms exist, these should be used and veil piercing

[71] The criticism is summarised by Lord Neuberger in *Prest v Petrodel Resources* at [75]–[78]. See also Cheng-Han Tan, 'Veil Piercing - a Fresh Start' (2015) 1 Journal of Business Law 20, 20–1.
[72] Gregory Allan, 'To Pierce or Not to Pierce? A Doctrinal Reappraisal of Judicial Responses to Improper Exploitation of the Corporate Form' (2018) 7 Journal of Business Law 559, 559.
[73] Prest v Petrodel Resources at [27].
[74] Prest v Petrodel Resources at [28].
[75] [1933] Ch 935.
[76] [1962] 1 WLR 832.

should only be a last resort.[77] Indeed, he went on to say that in almost every case of the evasion principle, it would not be necessary to pierce the veil because the facts would reveal other legal relationships between the company and its controllers.[78]

Although Lord Sumption stressed limitations on the availability of the mechanism of piercing the corporate veil, given his statements on the principled basis of the concept being abuse of the corporate form it is questionable if its application should be limited to the evasion category; there may be other actions which can be said to involve abuse of the corporate form.[79] Indeed, other judges in the case – Baroness Hale, Lord Wilson, Lord Mance and Lord Clarke – either expressed uncertainty that all cases could be classified into concealment or evasion or were unwilling to preclude all other possible situations in which veil piercing could arise.[80] Therefore although it seems there has been a strong attempt to limit the use of piercing the corporate veil to last-resort evasion cases and to put the mechanism on a principled footing, there may still be further movement in this area in English law in the future.

5.4.3 Liability based on control of the company

Section 251 of the CA 2006 defines a shadow director as "a person in accordance with whose directions or instructions the directors of a company are accustomed to act". Thus, shadow directors may be distinguished from *de facto* directors, for example, who claim or purport to act as directors and are held out to be directors by the company.[81] There appears to be a need for a course of conduct on the part of the board[82] – i.e. not merely a single act or occasion – and it must be conduct by the board rather than a single director.[83] The leading judicial analysis of the concept is given by Morritt LJ in *Secretary of State for Trade and Industry v Deverell*,[84] who stressed that the interpretation may depend on the statutory context

[77] Prest v Petrodel Resources at [35].
[78] Ibid.
[79] Tan (n 71) 32.
[80] Prest v Petrodel Resources at [92], [100], [103].
[81] Re Hydrodan (Corby) Ltd (In Liquidation) [1994] BCC 161 Ch D.
[82] At least a consistent majority of the board: *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch).
[83] *Re Unisoft Group Ltd (No.3)* [1994] BCC 766 Ch D at 774–775.
[84] [2001] Ch 340. See also *Palmer's Company Law*, vol 2, 8.217 (July 2019).

and may therefore be stricter in criminal or quasi-criminal provisions, and the purpose of the legislation is to identify those with real influence, and that (non-professional) advice is capable of falling within the scope of the provision; it is not necessary that the directors completely surrender their discretion. The scope of the provision is potentially broad: a holding company (and possibly also its directors), a consultant called into assist a corporate rescue, and a company's bank could potentially be shadow directors.[85] However, the fact that directors of a company are obliged to act in accordance with requirements laid down by a majority lender or customer for the protection of that person's interests does not necessarily make that person a shadow director.[86] Nevertheless, they may be found to be shadow directors if they pursue an interventionist policy in the company's affairs over time.[87]

The CA 2006 also provides particular statutory exemptions for those giving professional advice to a company and to parent or holding companies. A person is not to be considered a shadow director purely because the directors act on her advice given in a professional capacity.[88] Furthermore, a parent company is not regarded as a shadow director of a subsidiary by reason only that the directors of the subsidiary are accustomed to act in accordance with its directions or instructions.[89] However individual and personal instructions from a director of a parent company to the directors of a subsidiary could result in the director being a shadow director.[90] Where a person is regarded as a shadow director, many of the statutory duties and responsibilities imposed on directors by the CA 2006 apply. Those relevant to creditor protection include the general statutory duties of directors, "where, and to the extent that, the corresponding common law rules and equitable principles apply."[91]

The same basic formulation applies under relevant provisions of the CDDA and the IA86. Section 22 of the CDDA extends liability for disqualification on the grounds of unfitness to shadow directors, and Sections 214(7) and 246ZB(7) IA86

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[85] *Re Hydrodan (Corby) Ltd (In Liquidation)* [1994] BCC 161 Ch D; see also *Palmer's Company Law*, vol 2, 8.218 (July 2019).
[86] Instant Access Properties Ltd (In Liquidation) v Rosser [2018] EWHC 756 (Ch) at [254].
[87] *Re MC Bacon Ltd* [1990] BCLC 324.
[88] Section 251(2) CA 2006.
[89] Section 251(3) CA 2006.
[90] Re Hydrodan (Corby) Ltd (In Liquidation) [1994] BCC 161 Ch D; Secretary of State for Trade and Industry v Laing [1996] 2 BCLC 324 Ch D.
[91] Section 170(5) CA 2006.

extend the concept of wrongful trading to shadow directors, both using the same definition as the CA 2006.[92] However, the exception regarding parent companies does not apply. Thus, in a group company situation, where a company dominates and directs its subsidiaries it is likely that it will find itself a shadow director for the purposes of wrongful trading.[93] In addition, broader definitions apply in other provisions: Section 212 of the IA86 (summary remedy, discussed in Chapter 4) and Section 2 of the CDDA (disqualification for an indictable defence, discussed in Chapter 4) apply to any person who "has been concerned, or has taken part, in the… management of the company;" and Section 213 of the IA86 (fraudulent trading, discussed in Chapter 4) applies to "any persons who were knowingly parties to the carrying on of the business" for a fraudulent purpose.

From this discussion, it can be seen that English law has developed a concept of shareholder liability based on control of the company in a number of situations, through the concept of shadow directors. This dovetails with the general approach of English law to confer liability through provisions on directors' duties and liabilities, discussed in Chapter 4. This chapter will now discuss the third comparator jurisdiction, Germany.

5.5 Shareholder liability in German law

Similarly to both Thai and English law, as discussed above, the general rule in German law is that a GmbH is a corporate entity which is legally separate from its shareholders, and therefore, following registration, in principle only the company's assets may be used to satisfy the claims of its creditors.[94] However, as for both comparator jurisdictions, there are both statutory and judicially developed exceptions to this principle. Regarding statutory exceptions, perhaps the most important from a creditor protection perspective are those requiring reimbursement by shareholders of payments received in violation of capital maintenance rules under Section 30 of the

[92] Section 22(5) CDDA and Section 251 IA86.
[93] Although providing operational guidelines or requiring that certain decisions be approved by the parent company will likely be insufficient to make the parent company a shadow director: Royston Miles Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell 2011) 645.
[94] Martin Schulz and Oliver Wasmeier, 'Limited Liability Company (GmbH)', *The Law of Business Organizations* (Springer 2012) 103–4.

GmbH Act. These may result in joint and several liability of shareholders, and have been discussed in detail in Chapter 2. The other statutory exceptions are perhaps of less general importance for the protection of non-adjusting creditors due to their limited scope, and will not be discussed here.[95] Rather, this section will cover the judicially developed concepts of shareholder liability, in respect of which there has been much development in recent years, as discussed immediately below. Following the latest decisions of the BGH on this topic, strictly speaking, piercing the corporate veil is now probably only available in cases of asset commingling; however, shareholders may also be liable to the company for destroying the company's existence on a tortious basis, as reconceptualised by the *Trihotel* decision discussed below.

5.5.1 Historical background and developments

From as early as the 1920s the German courts recognised that shareholders could have personal liability if a company became insolvent because of their conduct.[96] From the 1980s to the early 2000s, the courts generally expanded the bases of liability for controlling shareholders of companies which became insolvent, for example due to undercapitalisation.[97] However, in a series of judgments in the mid-2000s the BGH clarified the position and, in doing so, strengthened the concept of limited liability.[98] The position prior to these judgments, and the judgments themselves will now be discussed.

Over few decades prior to the *Trihotel* decision in 2007, the BGH had developed two different approaches to shareholder liability. The first approach, which may be termed the "*de facto* group approach", conferred liability on a controlling shareholder of a GmbH for the company's debt through analogy to the provisions governing enterprise groups in the statute relating to public limited

[95] These are tort liability for providing false or incomplete information on or after formation of the company (Section 9a para 1 GmbH Act), compensation for damages from shareholder willful or grossly negligent impairment of the company through contributions or start-up costs (Section 9a para 2 GmbH Act), and, if the company no longer has a managing director, the obligation to file for insolvency immediately on the company becoming illiquid or overindebted, which liability is usually on the directors as discussed in detail in Chapter 4 (Sections 64 GmbH Act and 15a InsO).
[96] Holger Altmeppen, 'Farewell to "Penetration" in Corporate Law' (2007) 60 NJW 2657 (German language).
[97] Cheng-Han, Wang and Hofmann (n 22) 175.
[98] Altmeppen (n 96) 2659.

companies, the *Aktiengesetz* ("AktG"). Under the AktG, there are two different types of enterprise groups: "contractual groups" and "*de facto*" or "non-contractual" groups.[99] Contractual groups are formed through controlling agreements or price transfer agreements among different companies in a group, usually for tax advantages. By contrast, a *de facto* group is formed where dependent entities are joined together under the uniform management of a controlling enterprise. Where the controlling enterprise abuses its position, from an objective point of view, this arrangement becomes a "qualified *de facto* group."[100] Once established, there are requirements on the controlling enterprise to settle an annual deficit of its subordinate enterprises[101] and not to induce a subordinate to enter into disadvantageous transactions without giving compensation.[102] Although the AktG makes no mention of the GmbH, the German courts extended the application of the provisions to private companies by analogy, including cases involving groups of GmbHs in which the defendants were natural persons, whom the court treated as "controlling enterprises."[103]

This approach was criticised, both for the lack of a precise definition on when liability would arise and on the basis that the analogy to the AktG was inappropriate.[104] Perhaps as a result of this criticism, the BGH abandoned this approach in favour of the concept of "liability for destroying the company's existence" at the turn of the 21st century.[105] The shift was indicated first in the *Bremer Vulkan* case.[106] This case concerned stripping of assets from a controlled GmbH subsidiary by a parent company. The court observed, in passing, that the subsidiary should be protected not by application of the law on corporate groups, but by the concepts of both capital maintenance and the company's right to continuing existence. This latter right requires a controlling shareholder to pay due consideration to the

[99] The law on corporate groups is contained in Sections 300ff. AktG.
[100] Sections 311ff. AktG.
[101] Section 302 AktG.
[102] Sections 311 and 317 AktG.
[103] Cases include the Video case (BGH, Judgment of 23 September 1991 (BGHZ 115) 187) and the TBB case (BGH, Judgment of 29 March 1993 (BGHZ 122) 123).
[104] F Wooldridge, 'Controlling Shareholders' Liability in German Private Companies' (2005) 26 Company Lawyer 286, 286.
[105] Charles Zhen Qu, 'Recent German Developments in Company Controllers' Liability in Rescue Situations: A Comparative Evaluation' [2011] Journal of Business Law 330, 339. However, the term is potentially misleading since the company's existence need not be destroyed; rather it may simply become insolvent.
[106] BGH, Judgment of September 2001 (NJW 3622).

subsidiary's interests when interfering with its assets or business opportunities.[107] The parent company fails to meet this requirement if the subsidiary becomes unable to meet its obligations because of the parent's interference with its assets.[108]

This approach received its first direct application by the BGH in the KBV case in 2002.[109] This case involved a company's shareholders and directors transferring its assets to a sister company, resulting in the company being unable to meet contractual payment obligations. The court ruled that the shareholders were required to compensate the company on two doctrinal bases: liability for the company's destruction and liability in tort under Section 826 of the BGB. On the first ground, the court ruled that the privilege of limited liability granted under Section 13(2) of the GmbH Act was subject to the condition that the company's assets must be committed to the preferential satisfaction of creditors' claims while the company exists.[110] Shareholders only had access to surplus: assets not required for the company's obligations. The consequence of this abuse is the loss of the privilege of limited liability, to the extent that the loss suffered by the company is not redressed by the remedies available under Sections 30-31 of the GmbH Act, which concern capital maintenance as discussed in Chapter 2. In relation to the tortious basis, the court held that the shareholders had deliberately and in violation of good morals harmed the interests of the claimant, who was a creditor of the company, conferring liability under Section 826 of the BGB, one of the general tort provisions.

Five years after the *KBV* decision, the BGH again revised the basis for shareholder liability with the *Trihotel* decision.[111] Although the *Trihotel* decision retained the name and concept of the "liability for destroying the company's existence" approach, the court held that this is not treated as an independent basis of liability, subsidiary to the remedies for breaches of capital maintenance rules, but rather is a special category within tort under Section 826 of the BGB. Therefore, this is not considered piercing the corporate veil or an exception to limited liability.[112]

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[107] Qu (n 105) 340.
[108] Michael Schillig, 'The Development of a New Concept of Creditor Protection for German GmbHs' (2006) 27 The Company Lawyer 348.
[109] BGH, Judgment of 24 June 2002 (NJW 3024).
[110] ibid.
[111] Trihotel, BGH, Judgment of 16 July 2007 (II ZR 3/04).
[112] ibid at 22.

Importantly, the tort is committed against the company, not the creditor. A creditor must first establish a claim against the company and then enforce it by a motion of attachment to take transfer of the company's claim against the debtor.[113] Alternatively, an action may be brought by the insolvency office holder in formal insolvency proceedings.

The *Trihotel* approach addresses some of the doctrinal issues with the previous view of the concept of the 'liability for destroying the company's existence.' These issues included, in particular, tortious liability conferred directly on shareholders for losses caused to creditors where no duties to creditors had been breached; the extension of the capital maintenance doctrine which, again, concerned the relationship only between shareholders and the company; and finally the potentially wide-ranging impact on the principle of limited liability. The BGH confirmed the principles from *Trihotel* in the *GAMMA* decision, in which a number of obligations originally owed by other group companies were transferred to a company which became insolvent.[114] In this case, the BGH confirmed that mere undercapitalisation would not result in liability for destroying the company's existence, since shareholders are not required to provide a company with financial resources to meet all its liabilities; this would be incompatible with the principle of limited liability.[115] Rather, they are only required to abstain from depriving the company of its assets in a manner incompatible with the rules of capital maintenance, through channelling assets to themselves, sister companies, or related parties. Here, the company was fully capitalised as required by law, and the shareholders did nothing to deprive the creditors of their access to the company's assets when it was a going concern. The result of these latest decisions has been to rein in the extent of potential direct liability of shareholders to creditors and to confirm the principle of limited liability of shareholders. As a result, piercing the corporate veil and shareholder liability based on control of the company are now limited to the circumstances discussed below.

[113] ibid at 36.
[114] BGH, Judgment of 28 April 2008 (II ZR 264/06).
[115] ibid 16-22.

5.5.2 Piercing the corporate veil

As mentioned above, following the most recent judgments of the BGH, the concept of piercing the corporate veil has been given a more restrictive interpretation than previously thought. Although, as discussed below, the doctrine of piercing the corporate veil is probably now restricted to cases of asset commingling, some academics suggest that there is a residue of circumstances outside this in which it may still be possible to pierce the corporate veil. These include substantial undercapitalisation (*Qualifizierte Unterkapitalisierung*) and abuse of the corporate form (*Rechtsformmissbrauch*), which will briefly be discussed before this section addresses asset commingling (*Vermögensvermischung*).

Regarding substantial undercapitalisation, there is no rule requiring that a company must have adequate equity capital for the kind of business that it will be taking on, beyond the minimum capital amount required for registration as discussed in Chapter 2. Indeed, as discussed above, the BGH in *GAMMA* confirmed that undercapitalisation would not result in liability for destroying the company's existence.[116] However, some academics argue that, in exceptional circumstances, if the share capital *a priori* proves to be completely inadequate for the business purposes of the company, its size and economic activities according to its articles of association, then shareholders may have personal liability if the company later becomes insolvent.[117] However, there are no legal rules or reliable economic methods to identify such a situation, and only those shareholders who recognised, or could have been reasonably expected to recognise, the existence of the substantial undercapitalisation would be liable.[118] As a result, this appears perhaps only a theoretical source of liability for shareholders, particularly in light of the BGH judgments discussed above.

Likewise, shareholders may be liable in cases of abuse of the corporate form. For example, if a company is formed only for the purposes of collecting debt in order to act as a shield against creditors' claims, the courts may

[116] ibid.
[117] Schulz and Wasmeier (n 94) 105; Andreas Wien, *Commercial and Corporate Law: A Practical Introduction* (Springer-Verlag 2013) 177 (German language).
[118] Schulz and Wasmeier (n 94) 117.

disregard the structure and hold the shareholders liable.[119] However, it should be noted that it is legitimate to establish a company solely for enjoying the benefits of limited liability. In addition, liability is generally conferred on some basis other than piercing the corporate veil, using general principles of private law to free third parties from obligations and holding shareholders liable for a wrong committed directly to such third parties, the incorporation and use of the company being part of the wrong for which they are liable.[120]

Academics and the courts have repeatedly affirmed the concept of veil piercing in cases of asset commingling – where shareholders commingle the company's assets with their own – and the BGH explicitly stated in *Trihotel* that the principles applied in cases of asset commingling remain.[121] The doctrinal basis for veil piercing is abuse of the corporate form (*Rechtsformmissbrauch*) resulting in loss of the privilege of limited liability and application by analogy of Section 128 of the HGB which holds all of the general partners of a commercial partnership personally liable.[122] Asset commingling concerns situations where the company's assets and those of a shareholder cannot be separated from each other to such an extent that applying the principles of depletion of assets and consequential claims for return to the company, discussed in Chapter 2, are of no use.[123] Mere improper accounting, which clearly can give rise to claims by the company against its directors, is not a sufficient basis for veil piercing.[124] The situation of asset commingling is to be distinguished from *Sphärenvermischung*, literally 'the mixing of spheres', where a shareholder commingles the business of the company with her own, for example by concealing the distinction between herself and the company when dealing with third parties. In an older case, the BGH found the shareholder personally liable applying the principle of good faith under Section 242 of the BGB. However, some academics

[119] ibid 118.
[120] E.g. Section 123 BGB may release third parties from obligations, shareholder liability being conferred by Sections 826 and 823(2) BGB read with Section 263 StGB. See Cheng-Han, Wang and Hofmann (n 22) 183–4.
[121] BGH, Judgment of 16 July 2007 (II ZR 3/04) at 27. See ibid 180–2.
[122] Götz Hueck and Christine Windbichler, *Corporate Law* (21st edn, Auflage, München 2008) s 24 Rdn 30 (German language).
[123] Schulz and Wasmeier (n 94) 118; Cheng-Han, Wang and Hofmann (n 22) 182.
[124] BGH, Judgment of 14 November 2005 (2006 NZG 350) 15.

consider this case to be an outlier, and indeed the court did not use any vocabulary referring to veil piercing in its judgment.[125]

5.5.3 Liability based on control of the company

As discussed above, an important clarification of the law in this area was made by the BGH in the *Trihotel* decision. In this decision the court confirmed that shareholders may be liable for destroying the company's existence (*existenzvernichtender Eingriff)* through an application of Section 826 BGB, which establishes liability for damages if a person wilfully causes damage to another in a manner contrary to good morals. Four elements must be found to establish this liability: (i) the claimant must have suffered damage; (ii) the damage must have been caused by the conduct of the defendant; (iii) the conduct must have been contrary to good morals; and (iv) the defendant intended to cause damage. The *Trihotel* decision clarified that the proper claimant is not the creditors, but rather the company itself or, in formal insolvency proceedings, an insolvency office holder acting on its behalf – it is the company's, not the creditors', assets that have been interfered with.[126]

Examples of destructive interference include the transfer of assets from a company to its shareholder, allocating risks and losses to one group company and benefits and profits to another, cash management within group companies resulting in insufficient liquidity, and other measures in connection with intra-group liabilities.[127] Regarding the mental element of the shareholder, the shareholder must be aware that her conduct is detrimental to the company's finances and equally aware of the facts that mean her conduct is contrary to good morals, or in bad faith. However, she does not necessarily need to be aware that the law will consider her actions to be contrary to good morals nor is it required that she intends to harm creditors. The requirement is to know and accept that the company's ability to meet its obligations will be impaired as a result of her actions – *dolus eventualis*, discussed above in Chapter 3.[128] Importantly, liability can also be conferred beyond a single

[125] Cheng-Han, Wang and Hofmann (n 22) 183.
[126] Qu (n 105) 343.
[127] Schulz and Wasmeier (n 94) 106–7. See also the *Trihotel* decision, which involved termination of intra-group lease contracts and excessive security given for a debt.
[128] BGH, Judgment of 16 July 2007 (II ZR 3/04) 30.

layer of shareholding: i.e., shareholders of a parent company of the claimant company may also be held liable.[129]

As discussed above, this decision has brought important clarification to German law on this area, confirming that shareholder liability will generally be based on tort law principles under Section 826 of the BGB and that liability will generally be owed to the company rather than to creditors, who will generally only have an indirect claim against shareholders. Therefore, liability based on control of the company, via the tortious requirements under Section 826 of the BGB, appears to be primary doctrinal manner of holding shareholders liable based on control of the company, in situations outside of the rules concerning capital maintenance discussed in Chapter 2.

5.6 Comparative analysis and evaluation

This section compares the approach of each jurisdiction in relation to piercing the corporate veil and liability based on control of the company respectively. The final part of this section evaluates the approach of Thai law against the principles of creditor protection based on an ESV approach to corporate governance as discussed in Chapter 1.

5.6.1 Comparative analysis

The three comparator jurisdictions all take a restrictive approach to the application of the judicially developed doctrine of piercing the corporate veil. However, the conceptual basis for broader shareholder liability is fundamentally different, as discussed below. This comparative analysis, consistent with the discussion above, will deal first with piercing the corporate veil followed by liability based on control of the company.

In relation to Thailand, evidence from Thai Supreme Court decisions supports the conclusion that the courts may pierce the corporate veil to prevent the people concerned from using separate corporate personality to avoid pre-existing contractual obligations, in particular where the parties involved appear to act

[129] ibid 44.

in a manner that disregards separate corporate personality. Although some academics advocate for wider use of the doctrine, for example to include *alter ego* or circumstances of complete domination through an extension of the general requirement to act in good faith in Section 5 of the CCC, there is no clear evidence that the Supreme Court has accepted this interpretation of the law. Indeed, many of the examples of piercing the corporate veil cited by academics arguably use other legal concepts: analogical reasoning from other provisions of the CCC, the doctrine of vicarious liability, or direct agreements with shareholders. The analysis points to an extremely limited scope for the judicially developed concept of piercing the corporate veil in Thailand.

However, this stands in contrast to piercing the corporate veil by statute, via Section 44 of the CCPA. Although this does not provide a substantive cause of action, it extends liability in consumer cases beyond the separate person of the company and in disregard of the principle of limited liability. The use of this mechanism is subject to three important restrictions. First, it only applies to consumer cases: disputes between consumers and business operators in relation to goods and services or product liability cases. Second, the company must have been incorporated or have acted in bad faith or behaved deceitfully. Third, liability will not be conferred if the shareholder can prove her innocence. Nevertheless, in spite of these restrictions, Section 44 of the CCPA represents a notable extension of the concept of piercing the corporate veil and a fundamentally different approach to England or Germany.

In England, in the relatively recent case of *Prest v Petrodel Resources*, the Supreme Court has significantly clarified the legal principles relating to the judicially developed concept of piercing the corporate veil. Now, it appears that piercing the corporate veil will only be available, as a last resort, for cases which exhibit the ‘evasion principle’: where a company is interposed so that its separate legal personality will defeat the enforcement of a legal right against the person in control of it which exists independently from the company. Although there is some potential for further movement in the law on this issue, as discussed above, this judgment indicates that the doctrine is viewed as a residual option only to be used as a last resort. Although English law in this area has developed and fluctuated much over

the 120 years since the *Salomon* case, it now appears perhaps relatively similar in scope to that of Thai law.

Similarly to both Thai and English law, German law takes a restrictive view of the concept of piercing the corporate veil. This restrictive view is a relatively recent development, as in English law, made from a clarification of the interpretation of the doctrine made by the BGH in *Trihotel*. Although some academics have suggested that piercing the corporate veil may be possible in other exceptional circumstances, it now appears that the doctrine is limited to cases of asset commingling: where the company's assets and those of a shareholder cannot be separated from each other to such an extent that the capital maintenance rules and mechanisms for redressing their breach cannot be applied.

From this comparison, it can be seen that all three jurisdictions use the judicially developed concept of piercing the corporate veil only in very restricted circumstances: cases of attempting to evade pre-existing contractual requirements or clear examples of asset commingling. However, Thailand has embraced the concept of piercing the corporate veil in consumer cases via statute – Section 44 CCPA – which is a potentially important mechanism for the protection of one category of non-adjusting creditors in cases of dishonest business practices. Conversely, English law and German law appear to focus on conferring shareholder liability based on control of the company.

In relation to Thailand, there has not developed a general concept of shareholder liability based on control of the company. Although in certain situations, such as vicarious liability in the context of torts committed by employees, the courts appear to take a broad view to confer liability within corporate groups, it may be considered that this will rarely be of assistance to non-adjusting creditors. Therefore, it appears that Thailand's main approach to shareholder liability is by way of Section 44 of the CCPA.

By contrast, English law has developed a broad basis for shareholder liability through the concept of shadow directors. This is an extension of the broad regime of directors' liability, discussed in Chapter 4, to persons in accordance with whose directions or instructions the directors of a company are accustomed to act. Therefore, in situations where a shareholder or a parent company

dominates a subsidiary company they will be held to the same standard as directors in many circumstances, including in relation to directors' duties, liability for wrongful trading and director disqualification. This analysis reveals the emphasis, in terms of creditor protection, of English law on the directors' liability regime, which is extended by the concept of shadow directors to shareholders, where in practice they are the ones directing a company's operations.

Similarly to English law, German law, following the *Trihotel* decision, may also be seen to have extended the characteristics of its approach to director liability to shareholders. As discussed in Chapter 4, in cases of companies in financial difficulties, German law focuses on tort as the basis for conferring liability on directors, requiring them to compensate the company. In the *Trihotel* decision, the BGH confirmed that shareholders may be liable in tort for destroying the company's existence, where the shareholder has intentionally or recklessly caused damage to the company through conduct which is contrary to good morals. The proper claimant is the company rather than creditors directly, although in practice it seems that the insolvency office holder will frequently be the one claiming on behalf of creditors. However, it should also be noted that the development of the concept of capital maintenance discussed in Chapter 2 will, in many cases of asset dilution, provide a more effective means of returning assets to the company, given the objective nature of the elements to be made out by the claimant, as discussed.

Overall, therefore, the comparative analysis reveals, on the one hand, a similarly restrictive application of the judicially developed concept of piercing the corporate veil but, on the other, fundamentally different approaches for conferring shareholder liability more broadly. Thailand has adopted a statutory process for piercing the corporate veil in cases of bad faith or deceit, but this only applies to consumer cases. England and Germany, by contrast, appear to have extended the concepts underlying director liability, discussed in Chapter 4, to confer shareholder liability in the case of control of the company. England's approach is a direct extension of the director liability regime through the concept of shadow directors. Germany's approach is to develop liability between the shareholder and the company based on the tort of destroying the company's existence.

5.6.2 Evaluation of Thai law

As discussed in Section 5.2 above, the ESV perspective supports rules that disincentivise abusive behaviour on the part of a company's controllers, including shareholders, which prioritise the interests of shareholders over non-adjusting creditors. This is particularly the case where creditors have become the company's residual claimants, as discussed in Chapter 4. From the analysis above, the generally restrictive interpretation of the judicially developed doctrine of piercing the corporate veil may be seen to have advantages and disadvantages. The advantages particularly lie in the legal certainty created by the apparently very restricted scope of the doctrine, leading to the benefits of limited liability discussed above. However, the disadvantage is the potential lack of a remedy for non-adjusting creditors where a company has engaged in asset dilution to an extent that their claims cannot be satisfied. Connected to this is the absence of a disincentive on shareholders using their influence on directors to engage in abusive behaviour. This disadvantage will clearly be nullified if other mechanisms exist to ensure that misbehaving shareholders are required to compensate non-adjusting creditors.

Thai law's general approach in the field of shareholder liability focuses on Section 44 of the CCPA as discussed above. It is considered that this is an important mechanism for protecting consumers – one category of non-adjusting creditors – against abusive behaviour. In cases of bad faith or deceit, where the company has insufficient funds to pay compensation in a consumer case, the court may summon shareholders who, if they cannot prove that they are innocent, must pay compensation. This operates where non-adjusting creditors have become the company's residual claimants through its insufficient funds. It provides an incentive on shareholders to use their influence to ensure that the company does not engage in bad faith or deceitful activities. Due to the requirement for shareholders to prove their innocence, merely turning a blind eye to a company's activities would, it is suggested, be a risky strategy for a controlling shareholder. For these reasons, it is considered that Section 44 of the CCPA is consistent with the ESV approach.

However, it should be stressed that this approach only applies to consumer cases, and as such only protects one category of non-adjusting creditors and relies on them bringing a case to court and showing some evidence of bad faith or

deceit on the part of the company. Therefore, although the approach of Thai law is consistent with the ESV perspective of the corporate objective in respect of consumers, it is open to criticism that the framework for shareholder liability offers no protection in respect of other categories of non-adjusting creditors, such as trade creditors. Although the incentives created by Section 44 of the CCPA may act on shareholders to use their influence to monitor companies that they control – which other categories of non-adjusting creditors may benefit from – this is only the case for companies that deal with consumers, from whom there is a risk of litigation. It will not create incentives for shareholders in all companies. Indeed, due to the absence of a concept of shareholder liability based on control, outside of businesses which are likely to be subject to consumer litigation it seems that shareholders can generally put pressure on directors to make corporate decisions without incurring any additional responsibilities or liabilities. This is highlighted by the comparison with English law and German law, whose concepts of shadow directors and tort liability for destroying the company's existence apply regardless of the types of creditors with which a company is dealing. This analysis suggests that Thai law may potentially be improved through a more broadly applicable shareholder liability regime. The proposals for this are discussed in Chapter 6.

5.7 Conclusion

This chapter has addressed this dissertation's two initial research questions, of whether non-adjusting creditors are sufficiently protected, and how the law relating to their protection has developed, in relation to shareholder liability. Liability conferred on shareholders runs contrary to the concepts of the separate personality of the company and the limited liability of its shareholders. These concepts have important economic benefits, not just for investors but for the whole economy, and therefore wide disregard would have potentially far-reaching negative impacts. From the theoretical discussion at the start of this chapter, the ESV perspective supports rules that disincentivise abusive behaviour on the part of a company's controllers, including shareholders, that prioritise the interests of shareholders over non-adjusting creditors. This is particularly the case where creditors

have become the company's residual claimants as a result of depletion of the company's funds, as discussed in Chapter 4.

In relation to the second question, of development of the law, the concept of conferring liability on shareholders, particularly in cases of abusive conduct or bad faith, has been present virtually from the inception of the ideas of separate personality and limited liability in Thailand. However, it seems that a judicially developed concept of piercing the corporate veil has been applied in only very few circumstances. A relatively recent and potentially far-reaching change to this was made by Section 44 of the CCPA, which allows for shareholder liability via veil piercing in cases of bad faith or deceit by companies in consumer cases. This approach is distinctly different to the approaches of the comparator systems. While similarly adopting a restrictive approach to the judicially developed concept of piercing the corporate veil, English law has extended its director liability regime to shareholders through the concept of shadow directors and German law has developed shareholder liability through the tort of destroying the company's existence.

In relation to the first question, of whether non-adjusting creditors are sufficiently protected, the analysis performed in this chapter reveals that Section 44 of the CCPA is consistent with the ESV perspective of the corporate objective, the yardstick used by this dissertation as discussed in Chapter 1. However, the shareholder liability framework potentially remains deficient, since Section 44 of the CCPA only applies to consumer cases and therefore protects only one category of non-adjusting creditor. Proposals for improvement in relation to the approach to shareholder liability are made in Chapter 6, in accordance with this dissertation's third research question. However, it is notable in this regard that Thai law has developed an approach which focuses on veil piercing in cases of bad faith and deceit, rather than, for example, extending the tort regime, as in German law, through interpretation of similar provisions in the CCC or through extending director liability beyond *de jure* directors, as in English law. As a result, recommendations for bringing Thai law on shareholder liability further in line with the ESV perspective, in accordance with the third research question, should take into account the manner in which Thai law has developed. This dissertation will now draw together the analysis from the comparative

chapters on the different approaches to the protection of non-adjusting creditors and make and discuss recommendations based on the analysis.

CHAPTER 6
RECOMMENDATIONS

6.1 Introduction

This chapter will draw together the analysis of Chapters 2-5 of this dissertation to provide answers to the first two research questions posed in Chapter 1 and to propose recommendations for improvements that may be made to Thai law in accordance with the third research question. This dissertation began with two research questions: first, are non-adjusting creditors of private limited companies sufficiently protected in Thailand? And second, how has the law relating to the protection of non-adjusting creditors of private limited companies in Thailand developed? The first question is addressed by applying an ESV model to evaluate the existing legal regime. The second question is addressed through a comparative approach with English law and German law, which influenced the relevant legal rules. A comparative approach is used to reveal the path of development of Thai law, in order to make nuanced recommendations which align, so far as possible, with this path, in accordance with the third research question.

This chapter will proceed as follows. The first section will gather together the analysis from the preceding four chapters, which examined legal capital rules, challenging transactions, directors' duties and obligations to preserve creditors' interests, and shareholder liability respectively, and provide full answers to the research questions. The second section will propose nuanced recommendations for improvements of Thai law in relation to the protection of non-adjusting creditors, to address the weaknesses identified in the evaluation against the ESV model. The final section will conclude.

6.2 Results of Analysis

This section will address each of the research questions of this dissertation in turn, collating the analysis from the preceding chapters.

6.2.1 Question 1: Are non-adjusting creditors of private limited companies sufficiently protected in Thailand?

As discussed in Chapter 1, non-adjusting creditors of private limited companies are at risk of exploitation at the hands of company controllers, particularly through asset dilution, asset substitution and debt dilution. Furthermore, they are, by definition, unable to protect themselves through the negotiated mechanisms that are open to powerful adjusting creditors, such as taking security over the assets of the debtor company. Therefore, there is a role for law, particularly company law and bankruptcy law, in creating a legal environment that protects non-adjusting creditors.

However, in order to judge whether or not non-adjusting creditors of private limited companies are *sufficiently* protected, it is necessary to select a method for evaluation. This dissertation has adopted a normative model for evaluation, specifically the ESV perspective, which adopts the structure of instrumental stakeholder theories while employing the shareholder value maximisation approach as the method by which the different stakeholders' interests may be ordered. As argued in Chapter 1, the ESV model is appropriate due to its apparent adoption by policymakers in the CG2017 in relation to Thai listed companies. Its application to evaluate the regime relating to private limited companies is supported due to their impact on the economy, consistency between business organisational forms, consistency of policy towards the protection of non-adjusting creditors, and the goal of supporting the implementation of the CG2017 through creating consistent norms in the legal system.[1] In other words, the ESV model offers a credible normative model for law relating to private limited companies, including the principles for the protection of non-adjusting creditors.

Under the ESV approach, company managers must take into account the interests of all stakeholders who are impacted by the company's activities when making decisions. As a mechanism to trade-off the different interests, the ESV model selects the concept of maximisation of long-term shareholder value as the deciding factor. The justification for this is based on the shareholders' position as the "residual claimants" – the group entitled to whatever is left after claims with higher priority have been satisfied. However, this relies on shareholders actually being the

[1] See Chapter 1.2.1.1.

residual claimants: i.e., not receiving claims in priority to creditors, and having a reasonable possibility of recovering some value from the company in the future.

Therefore, as discussed at 1.2.1.2 above, there are three principled objectives for the law on this issue:

1. First, legal strategies may be used to ensure that shareholders do not make returns in priority to creditors. This is referred to as the concept of '**shareholders last**'.
2. Second, where the shareholders have no prospect of recovering value from the company, the creditors become residual claimants. Under the ESV model, the company must be run, ultimately, to maximise the interests of the residual claimants while considering all affected stakeholders. Therefore, legal mechanisms may be used to shift the company's objectives, requiring it to operate in the interests of creditors where they become residual claimants. This will be referred to below as '**objective shift**'.
3. Finally, the ESV model would support a legal environment which prevents a company from engaging in asset substitution and debt dilution. These mechanisms may enhance returns for shareholders in the short term but prejudice the stability of the company in the long term and thus damage the prospect of repaying creditors.

These principles may be used to evaluate the sufficiency of legal rules offering protection to non-adjusting creditors in Thai law, through the extent to which they represent an ESV model. Rules of law relating to the protection of non-adjusting creditors were separated into four categories for their evaluation against the ESV model: legal capital rules; rules relating to challenging transactions; directors' duties and duties to preserve creditors' interests; and shareholder liability. The weaknesses of the legal regime, by reference to this ESV standard, identified in the analysis in the preceding four chapters of this thesis are as follows (summarised in Table 4 below).

Table 4 – Summary of Evaluation of Creditor Protection Rules Against ESV Model

No.	Category of creditor protection rules	Identified legal concepts incompatible with ESV model	Description of incompatibility
1	Legal capital rules	• Complete prohibition on share purchases and redemptions • Requirement to contribute 25% of nominal value on issue • 10% nominal share value legal reserve	• Rules do not fit with the concept of '**shareholders last**'. • However, only the legal reserve issue presents a potential risk to non-adjusting creditors, as it permits asset dilution in certain circumstances
2	Challenging transactions	• Rules prioritise protection of honest counterparties in transactions at an undervalue with a company in financial difficulty • No presumptions on challenging transactions with related counterparties at an undervalue	• Rules do not strongly address asset dilution: does not fit with '**shareholders last**'. • Rules create inappropriate incentives for companies in financial difficulties: does not fit with '**objective shift**'.
3	Directors' duties and duties to preserve creditors' interests	• No recognition of general duty to consider creditors' interests • No shift in duties when company enters financial difficulties • Certain criminal provisions, but no director disqualification regime or civil or administrative sanctions	• Rules do not fit well with the concept of '**objective shift**'.
4	Shareholder liability	• Piercing the corporate veil is rare and offers only theoretical creditor protection • Section 44 CCPA offers important creditor protection, but only applies to consumers	• Rules are consistent with supporting the concepts of '**shareholders last**' and '**objective shift**', but scope is limited to consumer cases.

Legal Capital: Chapter 2 analysed the protection of non-adjusting creditors offered by rules relating to legal capital. The law in this area has several notable features which do not fit with the concept of shareholders last. Specifically, (1) complete prohibitions on share purchases and redemptions and (2) the requirement to contribute at least 25% of a share's nominal value on issue. These do not appear to have a strong creditor protection justification and go beyond what is required for shareholders last. The requirement to fill and maintain a 10% legal reserve fund at dividend distributions arguably may aim to preserve the concept of shareholders last by addressing a situation where the company has suffered trading losses between the time of preparation of its accounts and the date of payment of dividends to shareholders.

However, despite the advantage of simplicity, the one-size-fits-all approach of 10% of the nominal value of the shares lacks normative justification: since trading losses could easily exceed the 10% legal capital reserve, a company in such a situation would be permitted to distribute equity to shareholders where that distribution was justified from the profits of the previous year. Such trading losses would result in creditors becoming the residual claimants, and the dividend distributions would therefore represent asset dilution and a breach of the shareholders last principle. As a result, the rules relating to legal capital, as currently interpreted, do not strongly align with the ESV model.

Challenging Transactions: Chapter 3 analysed rules of law which allow creditors, or others on their behalf, to challenge transactions made by debtor companies. As discussed in that chapter, Thai law in this area takes a fundamentally subjective approach to challenging transactions, with the requirement to establish a mental element on the part of both the debtor company and the counterparty to the transaction (where the transaction is not gratuitous) in order for the transaction to be successfully challenged. The mental element – knowledge that the transaction would prejudice the creditor – is presumed both during a one-year twilight period before formal bankruptcy proceedings and in the case of gratuitous or unreasonably undervalue transactions. However, this is only a presumption; it can be overturned by either the debtor or the counterparty proving that they had no such knowledge.

As a result, it appears that the legal environment prioritises the protection of honest counterparties over creditors, and arguably incentivises potential counterparties not to investigate the surrounding circumstances where they see a good bargain. This has the advantage of allowing companies in financial difficulties to sell assets at low prices to preserve their liquidity and keep trading. However, it also results in an increased likelihood of asset dilution: value which could otherwise be used to repay creditors will be lost through undervalue transactions. This is particularly likely to harm non-adjusting creditors. The reason for making undervalue transactions to increase liquidity may be to continue to meet the demands of secured creditors. However, this would be at the expense of unsecured, including non-adjusting, creditors.

In addition, Thai law does not have tighter rules or presumptions for challenging transactions between connected parties other than in the case of preferences, which may increase the potential for asset dilution. As a result, the law relating to challenging transactions is not well aligned with the ESV model, since it does not strongly address asset dilution or create incentives to preserve value for non-adjusting creditors where a company is in financial difficulties. Indeed, the opposite incentives may be created.

Directors' Duties: Chapter 4 analysed duties that the law confers on those making business and policy decisions which offer protection to non-adjusting creditors. These comprise general directors' duties and duties to preserve creditors' interests when a company is in financial difficulties. Regarding the former, although Section 1169 does appear to recognise creditors' interests as indirectly relevant to directors' general duties – operating when they become the residual claimants, which is consistent with the ESV model – this does not appear to reflect the manner in which directors' duties are typically framed in academic literature. It is generally recognised that directors only need consider shareholders' interests when making decisions.

Regarding the latter category of duties, when a company encounters financial difficulties, there is no change in the nature of directors' duties and responsibilities. There is no requirement to file for bankruptcy or to consider business reorganisation – indeed, directors cannot file for bankruptcy themselves. There is no

concept of fraudulent or wrongful trading or tortious liability for continuing to trade. Instead, there are a number of criminal offences designed to ensure that directors are not acting abusively in the period before formal bankruptcy proceedings. However, there is no regime to disqualify misbehaving directors from acting as company directors in the future. Thai law in this area therefore has the significant weakness, from an ESV perspective, of lacking effective means of ensuring that directors make decisions in the interests of creditors when they have become the company's residual claimants.

Shareholder Liability: Chapter 5 examined the final category of legal rules offering protection to non-adjusting creditors: liability of shareholders for debts owed by the company. These rules were divided into piercing the corporate veil and liability conferred on shareholders on the basis of control of the company. As discussed in that chapter, a judicially developed concept of piercing the corporate veil has been identified by some academics. However, many of the relevant cases can be explained by the application of other legal principles, resulting in a conclusion that piercing the corporate veil is extremely rare, and potentially only a theoretical rather than practical protection for non-adjusting creditors.

By contrast, Section 44 of the CCPA offers an important mechanism for protecting consumers – one sub-category of non-adjusting creditors – against abusive behaviour. In cases of bad faith or deceit, where the company has insufficient funds to pay compensation in a consumer case, the court may summon shareholders who, if they cannot prove that they are innocent, must pay compensation. This operates where non-adjusting creditors have become the company's residual claimants, providing an incentive on shareholders to use their influence to ensure that a company does not engage in bad faith or deceitful activities.

Thus, Section 44 of the CCPA is consistent with an ESV approach. However, this will only apply to companies that deal directly with consumers – it will not create incentives on shareholders of all companies. Outside of businesses likely to be subject to consumer litigation, it seems that shareholders can generally put pressure on directors to make corporate decisions without incurring any additional responsibilities or liabilities. As a result, the law in this area does not align perfectly with the ESV model.

Overall, therefore, it is possible to answer the first research question of this dissertation: on the basis of the analysis above, **non-adjusting creditors of private limited companies in Thailand are not sufficiently protected from an ESV perspective.** There are deficiencies in the regime preventing shareholders receiving funds from the company in preference to creditors, both in the rules relating to legal capital and those relating to challenging transactions. There is no effective regime to incentivise directors to act in creditors' interests when they become the company's residual claimants, either in the rules relating to directors' duties or in the rules conferring liability on shareholders with the power to influence directors. Finally, there are deficiencies in rules preventing a company from engaging in asset substitution and debt dilution which prejudice the stability of the company in the long term and the prospect of repayment of creditors: the legal regime focuses on a relatively small number of specific criminal offences to prevent abuse in this area. This conclusion suggests that there are a number of ways in which the legal regime could be improved, as discussed below. In order that these improvements be tailored to the context of Thai law and its path of development, the second research question will now be addressed.

6.2.2 Question 2: How has the law relating to the protection of non-adjusting creditors of private limited companies in Thailand developed?

As discussed in Chapter 1, the ESV model of corporate governance provides the normative and theoretical basis for evaluation of the regime relating to the protection of non-adjusting creditors. However, it does not provide a blueprint for how such protection may be achieved. Since many of the rules have been in place for nearly a century, reform should be recommended with care and values evident in the system and its general approach should be respected where possible and not replaced without good reason. Therefore, recommendations for alterations should be nuanced and made with a thorough understanding of how the legal environment has developed over time: recommendations should, where possible, be made consistently with the path of development.

Legal Capital: As discussed in Chapter 2, although there are some influences from English law, the heaviest overall influence on the CCC and Offences

Act rules relating to legal capital is from German and Japanese sources. However, Thai law has adopted a different path of development from both German law and English law. Capital maintenance, important ever since the second half of the 19th century, continued to be central to the German approach and was used to develop broad creditor protection concepts, such as disguised distributions and shareholder loans substituting for equity. English law, by contrast, has gradually adopted more flexibility and less reliance on balance sheet tests in favour of directors' standards of conduct linked with the solvency statement approach in a number of areas. By contrast, Thai law has not used the CCC legal capital rules as the basis for developing a creditor protection regime. Rather, the approach appears to have been to rely on a rules-based approach to capital maintenance, such as sole reliance on accounts as the basis for permitting dividend distributions, combined with criminal offences to ensure compliance with this regime.

Challenging Transactions: As discussed in Chapter 3, Thai law shifted between an approach based on English bankruptcy law and a Roman-law-inspired model, through the link to Section 237 of the CCC created by Section 113 of the BA. As a result, the underlying doctrinal elements of the approach also shifted, to increase the focus on the mental state of the counterparty, collusion being of the essence of the right to challenge. Changes to Thai law have been to reduce general twilight periods, prioritising legal certainty over creditor protection, other than in the case of connected parties in relation to preferential transactions.

Notable developments in English law, by contrast, have included a reduction in the emphasis on establishing the mental element of the debtor, to the point of a purely objective test in the case of transactions at an undervalue pursuant to Section 238 of the IA86. German law has remained substantially similar to its 19th century form: changes have been to extend twilight periods and reduce the focus on the mental element of counterparties in the case of connected parties. However, the developments of the German legal capital regime have meant that transactions between a company and its connected parties may be challenged through the rules relating to disguised distributions, equity substituting shareholder loans, or the special challenge for preferential transactions in relation to shareholder loans under Section 135 of the InsO, all of which rely on objective criteria.

Therefore, the subjective approach in Thai law is revealed as distinctly different from the path of development of both English and German law – these have developed objective tests to challenge transactions, albeit German law's approach being within the doctrinal category of legal capital rules rather than challenging transactions. Thai law, ultimately, has developed to focus on protecting innocent third parties in the business environment, in priority to addressing the incentives for company insiders to benefit themselves at the expense of non-adjusting creditors.

Directors' Duties: As discussed in Chapter 4, the Thai provisions relating to directors' duties and obligations to preserve creditors' interests have their origin in a number of different pieces of legislation, including both English and German sources. However, there are also several provisions or aspects of provisions which do not appear to be adopted directly from other jurisdictions. English and German law were revised throughout the twentieth century generally in the direction of increasing creditor protection in this area, including through mechanisms requiring directors to file for formal insolvency proceedings, legislative changes to directors' duties, judicially developed shifts in directors' duties when a company is in financial difficulties or a direct tortious relationship between directors and creditors.

By contrast, Thailand has not adopted such developments. In spite of textual support for a shift of directors' duties in Section 1169 of the CCC, this has not evidently been recognised by the courts or academia. Instead, Thai law has maintained its emphasis on public enforcement of standards of directors' conduct via criminal law. However, despite this emphasis and unlike England and Germany, it has not developed a regime of public enforcement of directors' duties through a directors' disqualification process.

Shareholder Liability: As discussed in Chapter 5, Thai law, perhaps even more than English and German law, takes a restrictive approach to the judicially developed concept of piercing the corporate veil. However, Section 44 of the CCPA represents a notable extension of the concept of piercing the corporate veil in consumer cases where a company has acted in bad faith and a shareholder cannot prove her innocence. By contrast, English and German law both focus on conferring liability on shareholders based on control of the company. English law links up

shareholder liability with the directors' duties regime, using the concept of shadow directors. The German law approach is to connect with tort law as the basis for conferring liability, through the courts' recognition of the tort of destroying the company's existence, where the shareholder has intentionally or recklessly caused damage to the company through conduct which is contrary to good morals. Therefore, in the area of shareholder liability, the three jurisdictions have, again, taken different paths: Thai law allowing the corporate veil to be pierced in consumer cases where the company has acted in bad faith and a shareholder cannot prove her innocence; English law connecting shareholder control to the directors' duties regime; and German law conferring shareholder liability through tort law.

Gathering together the analysis above, the second research question of this dissertation may be answered. The analysis reveals that Thai law has not developed an objective approach to addressing the problem of asset dilution with connected parties, either through the legal capital regime or the approach to challenging transactions. In addition, it has not recognised a shift in directors' duties to protect creditors' interests, either through standards of directors' conduct that may be enforced privately or publicly in insolvency, or through requirements to seek the protection of a formal insolvency regime. Rather, the focus of Thai law appears to prioritise protection of innocent counterparties and flexibility of directors to run businesses. **The protection of non-adjusting creditors appears primarily achieved by way of public enforcement of criminal law, supplemented by the relatively recent innovation of privately enforced shareholder liability in cases of bad faith in the consumer context**.

6.3 Recommendations

In response to the third research question of this dissertation, this section will make specific recommendations for improvements in Thai law relating to the protection of non-adjusting creditors based on the analysis above. The recommendations are arranged in descending order of, in the author's view, their potential to have a positive impact on the protection of non-adjusting creditors in Thailand. As noted in the discussion below, some of the recommendations require

collective implementation in order to be fully effective, whereas others may be implemented individually. The recommendations and how they address each weakness identified from the evaluation against the ESV model performed in 6.2.1 is summarised in Table 5 below. All recommendations and their means of implementation are summarised at Table 7 at the end of this section.

Table 5 – Recommendations Addressing Weaknesses Against ESV Model Identified in 6.2.1

Identified weakness	**Recommendation 1**: Public enforcement of directors' duties and director disqualification regime	**Recommendation 2**: Recognition of directors' duties to act in the interests of creditors	**Recommendation 3**: Empowering and requiring company directors to consider initiating formal insolvency proceedings	**Recommendation 4**: Expanding CCPA approach beyond consumers	**Recommendation 5**: Revising the interpretation of the law relating to dividend distributions
Legal capital: 10% legal reserve ineffective, inefficient and lacks normative justification					X
Challenging transactions: fundamentally subjective creating inappropriate incentives	X	X			
Directors' duties: no shift to consider creditors' interests or contemplate protective insolvency procedure	X	X	X		
Shareholder liability: little protection from piercing corporate veil and S.44 CCPA only applies in consumer cases				X	

6.3.1 Recommendation 1: Public enforcement of directors' duties and a director disqualification regime

The first recommendation is to create a legal framework for public enforcement of directors' duties including a director disqualification regime. As discussed in Chapter 4, doubt has been cast around the world by government reports and academic research on the efficacy of private enforcement mechanisms of directors' duties. The prospect of non-adjusting creditors bringing private derivative claims against company directors appears slim due to the costs of litigation, the lack of access to information about directors' activities, and the fact that any compensation will be paid to the company rather than to the claimant.

By contrast, a regime of public enforcement has the advantages of the objectivity of a public authority as opposed to a party connected with the company, the experience and training of officials who continually pursue such actions, which can include warnings and settlements, and potentially better access to information through involvement and cooperation with relevant government departments.[2] Indeed, the deterrent effect created by a credible system of enforcement of directors duties may be considered more important than the redress achieved in specific cases.[3] Direct public enforcement of directors' duties has been adopted in several jurisdictions, including Australia[4] and New Zealand.[5] Finally, it is argued that a regime of public enforcement is particularly suitable to Thailand, given that the identified direction of development of the law in this area has been generally to rely on public enforcement via criminal law.

Regarding the specific direction for the development of public enforcement of directors' duties, it is recommended that Thailand adopt a regime allowing for sanctions which include the disqualification of offending directors from acting as company directors in the future. As discussed in Chapter 4, both English and German law provide for several instances in which public authorities can take action

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[2] Andrew Keay, 'The Public Enforcement of Directors' Duties: A Normative Inquiry' (2014) 43 Common Law World Review 89.
[3] Renee M Jones and Michelle Welsh, 'Toward a Public Enforcement Model for Directors' Duty of Oversight' (2012) 45 Vanderbilt Journal of Transnational Law 343, 371–2.
[4] Jenifer Varzaly, 'The Enforcement of Directors' Duties in Australia: An Empirical Analysis' (2015) 16 European Business Organization Law Review 281.
[5] Keay (n 2) 115.

resulting in a temporary or permanent ban. While Thai law contains several specific criminal offences relating to conduct prior to formal insolvency proceedings, even successful criminal prosecutions do not result in preventing those convicted from acting as directors of companies in the future. In an interview with a representative of the Department of Business Development of the Ministry of Commerce (the "DBD"), attached at Appendix 4, the issue of a lack of legal power for the DBD to disqualify individuals who had been found guilty of criminal conduct from being directors was expressed as a significant problem.[6]

Other Thai legislation allows the removal and disqualification of those holding analogous positions in different contexts from their posts. Powers are given to public authorities to remove directors and managers of financial institutions[7] and securities companies,[8] following which they will be unable to hold such positions in the future. However, the author recommends implementing a public enforcement and director disqualification regime which includes administrative sanctions, inspired by the Trusts for Transactions in Capital Markets Act BE 2550 (2007) ("TTCMA"). The possible administrative sanctions, which may be conferred for a breach of most trustee obligations under the TTCMA,[9] are probation, administrative fine of up to one million baht per count,[10] public reprimand, restriction on operating trust business, suspension of operation of trust business for a specified period, and revocation of approval.[11] In addition, the author recommends adopting a conceptual model which blends these administrative sanctions with a conceptual structure based on the director disqualification regime in Australian law, which gives strong powers to its equivalent corporate regulator, therefore providing a suitable conceptual model for Thailand.[12]

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[6] See Appendix 4 Question 2.
[7] Sections 24(5), 89(3), 90(4) and 91 Financial Institutions Act BE 2551 (2008).
[8] Sections 103, 144 and 145 Securities Exchange Act BE 2535 (1992).
[9] Section 70 TTCMA; See also Adam Reekie, Surutchada Reekie and Kaipichit Ruengsrichaiya, 'Legal Landscape of Trust Law in Thailand: The Fading Twilight of Common Law Trusts and the Sunrise of Statutory Trusts' (2021) 27 Trusts & Trustees 830, 11.
[10] Section 68 TTCMA.
[11] The SEC Office may only order probations and administrative fines, whereas the other sanctions must be made by an administrative panel of the SEC – Sections 69(2), 69(3) and 72 TTCMA.
[12] See Part 9.4 Division 2 of the Australian Corporations Act 2001; Ian Ramsay, 'Increased Corporate Governance Powers of Shareholders and Regulators and the Role of the Corporate Regulator in Enforcing Duties Owed by Corporate Directors and Managers' (2015) European Business Law Review 49; Tess Blackie and Jean Jacques Du Plessis, 'Australia' in Jean Jacques Du Plessis and Jeanne Nel de

6.3.1.1 Proposed director disqualification regime

In this section, the proposed conceptual model for a directors' disqualification and sanction regime is set out, summarised in Table 6 below. This model would require primary legislation through an Act in order to confer the relevant legal powers.

Under this model, a criminal offence is created whereby a person is criminally liable if they are found to manage a company while disqualified. The concept of managing a company is widely expressed to include making, or participating in making, decisions that affect the whole or a substantial part of the business of the company, or communicating instructions or wishes to the directors of a company while knowing that the directors are accustomed to acting in accordance with their instructions or wishes. The proposed Act would include provisions requiring the DBD to create and maintain a database of disqualifications, perhaps linked to the criminal records system, for the practical implementation of the system. There are three conceptual manners in which a director of a company may be disqualified: automatic disqualification; disqualification by court; and administrative sanctions (including disqualification).

Koker (eds), *Disqualification of Company Directors: A Comparative Analysis of the Law in the UK, Australia, South Africa, the US and Germany* (Taylor & Francis 2017) ch 3.

Table 6 – Summary of Proposed Director Disqualification Regime

	Automatic disqualification	**Disqualification by court**	**Administrative sanctions**
Relevant conduct	Conviction for offence under Sections 40 and 41 of the Offences Act, Section 350 of the Penal Code and Sections 164, 166 and 173 of the Bankruptcy Act	• Repeated convictions for offences under Sections 40 and 41 of the Offences Act, Section 350 of the Penal Code and Sections 164, 166 and 173 of the Bankruptcy Act • Repeated administrative sanctions • Repeated business failures of companies due to mismanagement	• Conduct prohibited under Sections 40 and 41 of the Offences Act, Section 350 of the Penal Code and Sections 164, 166 and 173 of the Bankruptcy Act • Breach of directors' duties to act in the interests of creditors when the company encounters financial difficulties • Other types of conduct pursuant to Ministerial Regulations
Legal result	5-year disqualification	Maximum 20-year disqualification	• Probation • Administrative fine • Public reprimand • Temporary prohibition from managing a limited company • Maximum 5-year disqualification
Effect of disqualification	• Criminal offence if found to 'manage a company' while disqualified. • To 'manage a company' means making, or participating in making, decisions that affect the whole or a substantial part of the business of a limited company, or communicating instructions or wishes to the directors of a limited company while knowing that the directors are accustomed to acting in accordance with their instructions or wishes.		

1. Automatic disqualification

A person would become automatically disqualified from being a director of a company when found guilty of committing specified criminal offences which reveal conduct which would make them unsuitable to be a director of a company in the future in view of the risk they pose to the public. The person convicted of a relevant offence would be disqualified for a period, for example five years,[12] running from the date of their release from prison for the relevant offence. The list of relevant offences, given the scope of this dissertation, would include the following: Sections 40 and 41 of the Offences Act, Section 350 of the Penal Code and Sections 164, 166 and 173 of the Bankruptcy Act, all of which were discussed in Chapter 4 as aiming to prevent behaviour harmful to non-adjusting creditors. Automatic disqualification for the commission of these offences would both present an additional deterrent to directors and protect non-adjusting creditors from such harmful action in the future.

While the criminal provisions above represent the core criminal law provisions which aim at preventing actions which are harmful to non-adjusting creditors, other criminal provisions, beyond the scope of this dissertation, could be included in the list of relevant offences in the proposed Act. Potential examples would include other criminal provisions which indicated dishonesty on the part of directors, implying their unfitness to manage a limited company. Although offences which involve deliberate deception lie outside of the scope of this dissertation, it is suggested that convictions for various types of fraudulent conduct in relation to conducting business could be included in the automatic disqualification regime. A further potential permutation would be to include a requirement for a sentence of imprisonment – for example one year – to ensure that disqualification only operates in suitably serious cases.

2. Disqualification by court

In addition to automatic disqualification, the courts would have the power to make an order for disqualification of a director. It is envisaged that the period of disqualification under this procedure would be longer than automatic

[12] Five years is chosen to be in line with Section 50 of the Penal Code as discussed in Chapter 4.

disqualification described above – for example, a maximum of 20 years[13] rather than the five years suggested for automatic disqualification. The purpose of this manner of disqualification would be to ensure that persons who had committed repeated conduct demonstrating that their managing a limited company poses a continued risk to the public are denied the opportunity to use the protection of limited liability to harm creditors in the future. A request for such disqualification would be made to the court by the DBD.

Conduct that would result in such disqualification would include repeated instances of committing the offences referred to in relation to automatic disqualification above, repeated administrative sanctions, and repeated business failures of companies of which the individual was a director, resulting in a failure to repay creditors, where her mismanagement played a role in the failure of the company.

3. Administrative sanctions (including disqualification)

In addition to automatic disqualification and disqualification by the court, it is proposed that a regime for administrative sanctions be created, based on the model in the TTCMA. As discussed in detail in this dissertation, under the ESV model, the shift in directors' duties to act in creditors' interests is only triggered when creditors become the residual claimants due to a reduction in the assets of a company. As a result, misconduct of directors will likely only be discoverable when a company enters formal insolvency proceedings, identified by the insolvency office holder in carrying out her duties. Thus, it is recommended that the appropriate public authority to investigate director misconduct occurring in the period prior to insolvency is the insolvency office holder who, as discussed in Chapter 4, is empowered to be an enquiry official under the Criminal Procedure Code in relation to any apparent wrongdoing discovered in the discharge of her duties. However, the public authority most appropriate to confer the sanctions would be the DBD,

[13] The maximum 20-year term is inspired by Section 206D of the Australian Corporations Act 2001.

specifically the Legal Office which has responsibility for dealing with civil, criminal, and administrative cases on behalf of the Department.[14]

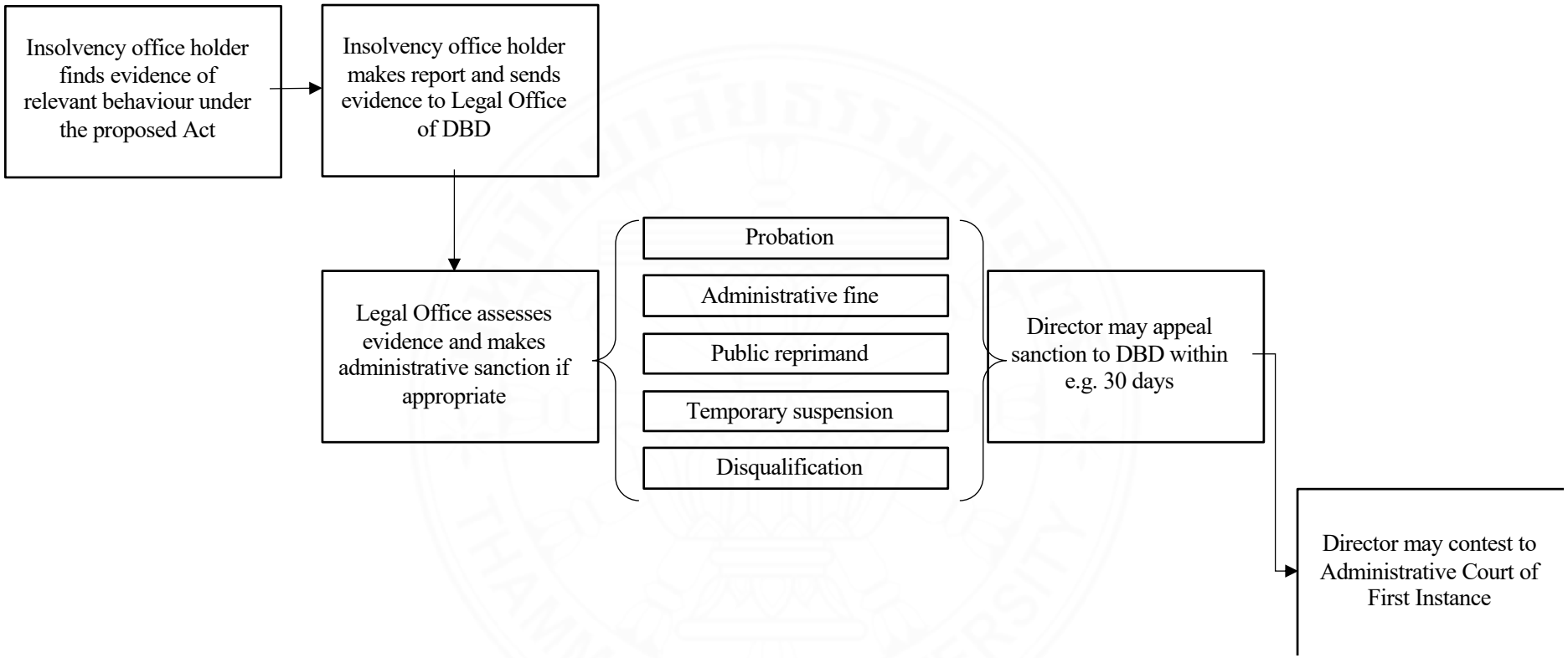
The recommended procedure is as follows (displayed graphically at Figure 3 below). Where the insolvency office holder, in the conduct of bankruptcy or business reorgansation proceedings, uncovers evidence of conduct which would attract a sanction under the proposed Act, it must make a report and pass the relevant information to the Legal Office of the DBD. The Legal Office (or potentially an administrative panel within the Legal Office) would then be empowered to issue the following sanctions, based on the same legislative model as the TTCMA: probation, administrative fine, public reprimand, temporary prohibition from managing a limited company, and disqualification from managing a limited company. Disqualification would be for a maximum term of 5 years, as for the automatic disqualification described above.

Relevant conduct for the purpose of these administrative sanctions would include the following:

- Conduct prohibited by Sections 40 and 41 of the Offences Act, Section 350 of the Penal Code and Sections 164, 166 and 173 of the Bankruptcy Act. While automatic disqualification applies for those convicted of these offences as described above, including this conduct in the administrative sanctions regime has the benefit, from an enforcement point of view, of a lower burden of proof than the criminal standard.
- A breach of directors' duties to act in the interests of creditors when the company encounters financial difficulties, as described in Recommendation 2 below.
- Other types of conduct, authority for administrative sanctions in respect of which is to be conferred through ministerial regulations passed under the proposed Act from time to time.

[14] See Article 15(2) of the Ministerial Regulations on the Governance of the Department of Business Development of the Ministry of Commerce BE 2556 (2013). Legal power of appropriate scope is conferred to the DBD via these regulations, issued pursuant to Sections 8 chor and 19 of the State Administration Act BE 2534 (1991) (as amended) read with Sections 28 and 29(8) of the Reorganisation of Ministry, Sub-Ministry and Department Act BE 2545 (2002).

Figure 3 – Suggested Procedure for Administrative Sanctions



In accordance with the model from the TTCMA, an individual against whom an administrative sanction has been made will have an opportunity to appeal the sanction to an administrative panel within the DBD within 30 days. In addition, an appeal may be made through the administrative courts system.

The advantages of this recommendation are as follows:

- The proposed regime creates a credible deterrent that may help to prevent company directors engaging in behaviour resulting in harm to non-adjusting creditors.
- It is in line with the general direction of development of the Thai legal framework for creditor protection, relying on public enforcement, as discussed in this dissertation.
- The additional resources required by the proposed regime are potentially not over-burdensome, since (i) cases would arise only out of a subset of formal bankruptcy proceedings of limited companies and (ii) costs could be offset, to some extent, from administrative penalties levied against directors.
- The insolvency office holder is well-placed to uncover evidence of misconduct in the course of its existing duties in formal bankruptcy proceedings, and the additional burden of passing evidence onto the Legal Department may not incur unfeasible additional costs compared to the benefits produced.
- The Legal Office of the DBD has deep experience of applying company law, access to information about all limited companies and their directors due to company filings, and the increase in its workload ought not to be significant since cases would only arise out of a subset of formal bankruptcy proceedings.

The disadvantages of this recommendation are as follows:

- Although the proposed regime has been designed with the objective of minimising costs, it must be recognised that any additional procedure

requiring further action on the part of public authorities will incur costs which must be met from the nation's budget. Additional costs would include those of creating and maintaining a database of disqualified individuals and incorporating a check against this database into DBD processes. Although it is argued that the costs of the proposed regime are relatively small, a formal cost/benefit analysis would be required to justify the adoption of the regime; since the main objective is broad deterrence of director misconduct, the benefits may be difficult to quantify financially.

- Issues may be encountered during the establishment of this regime due to the integration with the records of director appointments held at the DBD. Until recently, there was no requirement for identification numbers from individuals appointed as directors, and therefore in some cases it may be difficult to identify all the directorships an individual holds.[15] However, over time such issues will decrease due to new registration requirements.
- To be effective, the proposed regime must be adopted together with the second recommendation detailed below at 6.3.2. In order to protect non-adjusting creditors using public enforcement of directors' duties, a duty of directors to act in creditors' interests must also be recognised, publicised, and built into the regime for public enforcement.
- Since the recommendation requires legislative intervention, the full legislative and consultation process must be followed, incurring delays, and raising the possibility that the recommendations may not be adopted or may be adopted in a different form to that recommended here.

6.3.2 Recommendation 2: Recognition of directors' duties to act in the interests of creditors when the company encounters financial difficulties

As discussed above, the regime proposed by Recommendation 1 will only create an effective deterrent against conduct which causes harm to non-adjusting creditors, in accordance with the ESV model of corporate governance, if a requirement to act in the interests of creditors when the company encounters financial

[15] See interview with DBD representative, included in Annex 3.

difficulties is recognised as forming part of the content of directors' duties of private limited companies. Therefore Recommendation 2, which links to Recommendation 1, is that directors' duties to act in the interests of creditors be formally recognised and taken into account in the application of the administrative sanctions adopted through Recommendation 1. This would bring Thai law into closer alignment with the ESV model as discussed above.

In order to do this effectively, this duty must both be recognised by the DBD, as the entity responsible for ordering administrative sanctions under Recommendation 1, and publicised in order for all company directors to be aware of the existence and nature of the duty. In order for the DBD to clearly recognise the duty, it is recommended that it be explicitly stated in relevant ministerial regulations under the Act referred to in Recommendation 1 that compliance with the creditor-regarding duty will be taken into account in considering whether to order administrative sanctions on directors. Matters to be taken into account would include: evidence of the directors recognising when the company encounters financial difficulties and altering their considerations and policy direction to act in accordance with the interests of the company's creditors (including non-adjusting creditors); directors considering taking out third party liability insurance to help protect victims of wrongful acts, where this may be relevant; a process of identification of all creditors, including non-adjusting creditors; directors' analysis of the impact of business decisions on the likelihood of repaying creditors; directors monitoring the company's financial situation and taking steps to address its worsening, including considering financial restructuring or a business reorganisation procedure.

In order to raise awareness of this, the DBD should engage in a publicity campaign including the recognition of this duty and the matters that will be taken into account in order to consider it satisfied. It is recommended that a handbook of good conduct be prepared and issued (electronically) to directors on their appointment, including the creditor-regarding directors' duty and the relevant sanctions. In addition, it is recommended that best practice be adopted in the form of recording board resolutions. The DBD should encourage companies to include consideration of the company's current financial position and the potential impact on

creditors (including non-adjusting creditors) of decisions in their recording of decisions made in meetings.

The advantages of this recommendation are as follows:

- It is necessary for the creditor-regarding duty to be recognised in order for the public enforcement of directors' duties under Recommendation 1 be effective for improving the protection of non-adjusting creditors.
- The publicity campaign and raising awareness among directors could be achieved in a relatively cost-effective manner through the use of electronic documents distributed to directors upon appointment.
- An approach for introducing best practice by way of disclosure, such as through proposing best practice in recording decisions of board meetings as recommended here, has shown itself to be effective in other areas in Thailand, such as through the increase in levels of corporate social responsibility reporting following similar policies developed by the SEC in relation to annual reporting by listed companies.[16]

The disadvantages of this recommendation are as follows:

- Ministerial regulations will be required under the Act proposed in Recommendation 1 in order to clearly implement this policy. The adoption of ministerial regulations may require consultation with the Council of State in relation to the DBD's interpretation of the creditor-regarding directors' duty, which may lead to a different interpretation of the matters to be taken into account than that proposed here.
- A publicity campaign by the DBD in relation to directors' duties will have cost consequences, although these may be minimised by the use of electronic documents.

[16] Panya Issarawornrawanich and Suneerat Wuttichindanon, 'Corporate Social Responsibility Practices and Disclosures in Thailand' (2019) 15 Social Responsibility Journal 318; Muttanachai Suttipun and Anchalee Bomlai, 'The Relationship between Corporate Governance and Integrated Reporting: Thai Evidence' (2019) 20 International Journal of Business & Society 348; Suneerat Wuttichindanon, 'Corporate Social Responsibility Disclosure—Choices of Report and Its Determinants: Empirical Evidence from Firms Listed on the Stock Exchange of Thailand' (2017) 38 Kasetsart Journal of Social Sciences 156.

- A change in best practice in relation to documenting board decisions may result in some impacts on businesses through the implementation of a new aspect in their corporate processes.

6.3.3 Recommendation 3: Empowering and requiring company directors to consider initiating formal insolvency proceedings when appropriate, including consideration of non-adjusting creditors

As discussed above, the ESV model requires a shift in the ultimate interests served by the company from those of shareholders to those of creditors, particularly non-adjusting creditors, when the latter become the residual claimants. When companies are in financial difficulties, under this view, directors are required to make decisions to run the company to promote the interests of creditors, including non-adjusting creditors, in recovering the debts owed by the company. Corporate bankruptcy processes are created by the law with the intention of preserving an insolvent company's assets and realising them in an orderly fashion for the satisfaction of creditors' claims. Therefore, it is recommended that Thai bankruptcy law be revised to enable companies in financial difficulties to more easily access these creditor-protective processes in accordance with their duty to promote the interests of creditors.

As discussed in Chapter 4, the BA does not permit debtor companies to file a petition for insolvent liquidation proceedings: this must be done by a creditor.[17] Regarding business reorganisation under Chapter 3/1 of the BA, until 2016 a balance sheet insolvent debtor could petition the court for business reorganisation provided that it was in debt to one or more creditors in the amount of at least THB 10m. Amendments to the law in 2016 and 2018 were made to improve access to the business reorganisation procedure for SMEs, reducing the amount of required indebtedness to THB 3m and introducing a cash-flow insolvency test.[18] However, the amendments have apparently not been successful: according to a report of the Legal Execution Department in 2020, there were only seven cases brought to

[17] Section 9 BA.
[18] See final note to the Bankruptcy Act (No. 9) BE 2559 (2016) and Section 8 of the Bankruptcy Act (No. 10) BE 2561 (2018).

the Bankruptcy Court under Chapter 3/2, only two of which were successful.[19] In reaction to this and to the COVID-19 pandemic, the cabinet has recently approved, in principle, a further amendment to the business rehabilitation procedure in several important respects.[20] First, the requirement for SMEs to register with the Office of Small and Medium Enterprise Promotion or other government agencies in order to access business rehabilitation is proposed to be removed. Second, the requirement for a business rehabilitation plan to be prepared prior to petitioning the court is proposed to be removed, with temporary protection put in place until a plan is prepared. Third, the proposal includes an expedited business rehabilitation process where creditors approve pre-packaged schemes. Finally, the maximum amount of debt that a business may owe in order to access the procedure for SMEs is proposed to be raised to THB 50m.

Improving access of limited company debtors to the business rehabilitation process is a welcome development from the point of view of protection of non-adjusting creditors. The protections afforded by such processes increases the likelihood of a company continuing to operate and therefore repaying non-adjusting creditors, without engaging in harmful practices described elsewhere in this dissertation. It is premature to comment on the latest draft amendment, which may be subject to significant revision during the legislative process. However, from the perspective of protecting non-adjusting creditors, an aspect that would improve the impact of the proposed amendments would be to include a requirement to consider the impact of the rehabilitation plan on non-adjusting creditors. Where the rehabilitation plan inappropriately disadvantages non-adjusting creditors, it is proposed that this should be a reason for the court to withhold its approval of a business rehabilitation plan. In addition, as mentioned above, consideration of business rehabilitation should be made by directors of companies when they encounter financial difficulties, as a part of the discharge of directors' duties as described above.

The advantages of this recommendation are as follows:

[19] <https://www.led.go.th/opinions1/pdf/report-30102563.pdf> accessed 11 November 2022.
[20] <https://www.thaigov.go.th/news/contents/details/44640> accessed 11 November 2022.

- Early access to the business rehabilitation procedure would reduce the opportunities for directors to engage in the harmful behaviours of asset dilution, asset substitution and debt dilution, due to increased monitoring under this procedure.
- The protections afforded by the business rehabilitation procedure would be beneficial to non-adjusting creditors, since they prevent secured creditors from enforcing their security and thus effectively terminating the business without regard to the interests of non-adjusting creditors.
- The interests of non-adjusting creditors can be protected directly by the court through its approval or otherwise of the business rehabilitation plan.

The disadvantages of this recommendation are as follows:

- The existing law and the current proposed legislative amendments make no special mention of the interests of non-adjusting creditors and inserting this during this part of the legislative process may not be realistic. This proposal would therefore most likely require a further amendment to the BA.

6.3.4 Recommendation 4: Expanding CCPA approach beyond consumer cases

As discussed above, the relatively recent innovation of Section 44 CCPA provides an important tool for the protection of one class of non-adjusting creditors: consumers. This acts to remedy particular consumers where a company has insufficient assets to meet their claims and shareholders cannot prove innocence. However, it also serves as a mechanism to incentivise shareholders to properly capitalise companies dealing with consumers, monitor them, and ensure appropriate insurance products are in place to meet claims. It is recommended that the extension of this regime be made to apply to all victims of wrongful acts committed by companies.

As discussed in Chapter 5, it has been argued by a number of academics that limited liability incentivises the externalisation of accident costs without apparently creating any efficiencies, since creditors cannot bargain in advance in

relation to the risks.[21] Although few scholars advocate for total abolition of limited liability in the context of tort due to potentially prohibitively high costs, several argue for an increase in piercing the corporate veil in relation to tort claims.[22] Since the regime under the CCPA is limited to situations of bad faith or deception, in accordance with Thailand's general approach to creditor protection, it is argued that the extension of the regime in the CCPA would not result in prohibitively high costs for limited companies. Instead, it would have the beneficial effect of increasing capitalisation, monitoring, and the use of insurance products to protect this wider class of non-adjusting creditors in addition to consumers.

The advantages of this recommendation are:

- This addresses a notable deficiency in Thai law when compared to English and German law. As discussed in Chapter 5, English law imposes shareholder liability through the concept of shadow directors and German law has developed the concept of a tort for destroying the company's existence. Thai law, however, has not judicially developed a shareholder liability regime, apart from a theoretical possibility to pierce the corporate veil. The experience of Section 44 of the CCPA suggests that intervention of the legislature is required to address this deficiency.
- Section 44 of the CCPA marked a notable change to the previous regime. This recommendation extends the same concept to a wider class of non-adjusting creditors. It is argued that this is preferable to creating a separate concept for conferring liability through different concepts such as tort or shadow directors adopted from other jurisdictions, for example.

The disadvantages of this recommendation are:

[21] Henry Hansmann and Reinier Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) Yale Law Journal 1879.
[22] Paul Halpern, Michael Trebilcock and Stuart Turnbull, 'An Economic Analysis of Limited Liability in Corporation Law' (1980) 30 University of Toronto Law Journal 117; Frank H Easterbrook and Daniel R Fischel, 'Limited Liability and the Corporation' (1985) 52 University of Chicago Law Review 89; Stephen M Bainbridge, 'Abolishing Veil Piercing' (2000) 26 Journal of Corporate Law 479.

- This would require legislative intervention through an amendment to the Civil Procedure Code, to insert a concept based on Section 44 of the CCPA but applying to all wrongful acts claims against limited companies. The full legislative and consultation process must therefore be followed, raising the possibility that the recommendations may not be adopted or may be adopted in a different form to that recommended here.
- This would likely be regarded by affected parties as a major legal doctrinal shift, and a significant alteration to the concept of limited liability. It would likely be argued that the basis of calculating the risk of investment in limited liability companies would be impacted, with significant potential economic consequences. The author would counter-argue that the adoption of this recommendation would only impact shareholders who are not acting in good faith, and that Section 44 of the CCPA has been in place for over a decade and therefore has been accepted by society without notably negative consequences. However, it may be the case that the proposed amendment to the Civil Procedure Code would meet strong resistance from some investors, and therefore it might not emerge successfully through the legislative process.

6.3.5 Recommendation 5: Revising the interpretation of the law relating to dividend distributions

As discussed in Chapter 2, a key conceptual difference between Thai law and the comparator jurisdictions, in relation to distributions, is that in both English law and German law even properly prepared accounts are not the final word on the amount that may be distributed. Rather, the directors must have regard to the future solvency of the company in the period following the distribution of dividends. Rather than capital maintenance rules only considering whether the amount of capital contributed by shareholders is being returned to them in priority to creditors, a consideration of solvency looks to preserve the business of the company, and protect creditors, in the long term. This additional forward-looking solvency-based requirement tied to standards of directors' conduct is not currently present in Thai law. However, this may arguably be balanced by the Thai law requirement, not

present in English or German law, of the accruing 10% legal capital reserve which must be filled before distributions are paid. This could be seen as an attempt to account for losses incurred since the preparation of accounts. However, it is argued that this is not a tailored approach to this issue; 10% could be too much or too little depending on the circumstances of the company involved.

Section 1201 of the CCC states that dividends may only be paid out of profits and that losses must be made good before dividends are paid. Rather than tying this to previous accounts, it is argued that this should be interpreted to refer to the company's position at the time dividends are actually paid, and 'losses' should include those incurred after the preparation of the company's accounts. The responsibility for this calculation is on the company directors, since Section 1168(3) gives them the specific duty of the proper distribution of dividends as prescribed by law.

It is argued that this legal interpretation should be adopted by the DBD and applied in accordance with the regime for public enforcement of directors' duties outlined in Recommendation 1 above, requiring an Act of Parliament and associated Ministerial Regulations. As a matter of best practice shareholders' or board of directors' resolutions should record that the directors have (i) taken appropriate steps to ensure that accounts have been properly prepared for the purpose of establishing the availability of sufficient profits to make the dividends lawful, including the consideration of full information regarding the company's financial position and an assessment of business risks between the date of declaration of dividends and their payment that might result in insufficient profits to cover the dividend payment, and (ii) sought appropriate accounting or legal advice or both to ensure that there will be sufficient reserves after the payment of dividends for the continuation of the company's business.

It is unfeasible for directors to have perfect information about the exact financial status of the company at any particular moment, and also impossible for them to predict the future and what the state of the company's finances will be at the time of the dividend payment. However, it is argued that it is preferable, from an ESV perspective, that the company's continuing financial provision be considered by the directors in respect of dividend payments. As discussed in detail above, an excessive

dividend distribution is asset dilution; where a company does not have sufficient profits, the directors must consider the interests of creditors, including non-adjusting creditors, which are served by the continuing operation of the company rather than by distributing cash to shareholders. Where the directors have made insufficient investigation of the company's finances resulting in an excessive dividend payment, directors should be considered to have breached their duties and be subject to the public enforcement regime outlined above.

The advantages of this recommendation are:

- No legislative intervention is required to adopt the interpretation proposed by this recommendation since, as argued above, the existing provisions of the CCC may be interpreted in this manner.
- The best practice of including the relevant considerations in board resolutions will, it is argued, act as a continual reminder to directors of the nature of their duties as regard dividend payments. When combined with the public enforcement regime in Recommendation 1, this would provide a powerful tool in resisting pressure from shareholders to pay excessive dividends.
- The more nuanced considerations of the actual financial position of the company results in a more tailored response to the company's business and circumstances than the existing approach.
- A revision of the interpretation of the existing dividend regime could pave the way for broader revisions of this part of the law. As discussed in Chapter 2, there are a number of provisions regarding dividends and legal capital generally which do not appear to offer significant protection to creditors and result in inefficiencies for companies. It is argued that these could be removed or extensively revised to increase flexibility for businesses without significant impact on creditor protection.

The disadvantages of this recommendation are:

- The existing regime has the advantage of simplicity and objectivity, meaning that directors have confidence that they will not attract liability

for dividends provided they were declared in accordance with the previous balance sheet. As a result, businesses may resist the proposed interpretation, on the basis that it will result in additional costs for their businesses. However, it may be countered that such costs are justified by the requirement to prevent asset dilution.

Table 7 – Summary of Recommendations and Means of Implementation

No.	Recommendation	Description	Method of implementation
1	Public enforcement of directors' duties and director disqualification regime	• Regime for disqualification and administrative sanctions of directors o Automatic disqualification on commission of certain criminal offences o Disqualification by court for repeated abusive behaviour o Administrative sanctions (including disqualification) by DBD for abusive behaviour prior to insolvency	• Act of Parliament to create the necessary legal framework including amendments to the BA
2	Recognition of directors' duties to act in the interests of creditors	• Recognition of duty to act in the interests of creditors when a company experiences financial difficulties, to be taken into account in the public enforcement regime in Recommendation 1.	• Act of Parliament and related Ministerial Regulations pursuant to Recommendation 1 • Raising awareness through actions taken by DBD.
3	Empowering and requiring company directors to initiate formal insolvency proceedings when appropriate, including consideration of non-adjusting creditors	• Recognition of a requirement for directors to consider initiating formal insolvency proceedings, such as business reorganisation, when a company encounters financial difficulties, to be taken into account in the public enforcement regime in Recommendation 1. • Include consideration of impact on non-adjusting creditors in procedure for court's approval of business reorganisation plan	• To be included in Act of Parliament and Ministerial Regulations pursuant to Recommendation 1. • Include consideration of non-adjusting creditors' interests by the court in proposed legislative amendments to the BA
4	Expanding CCPA approach	• Adopt the same mechanism as present in the CCPA in	• Legislative amendment to the Civil Procedure Code

No.	Recommendation	Description	Method of implementation
	beyond consumers	relation to all claims for wrongful acts made against limited companies	
5	Revising the interpretation of the law relating to dividend distributions	• Revise the interpretation of the law relating to dividend distributions to require directors to consider the impact of paying distributions on the financial position of the company at the time of their payment.	• To be included in Act of Parliament and Ministerial Regulations pursuant to Recommendation 1. • DBD to issue best practice guidance for documenting board meetings including a statement that directors have properly considered the company's financial position, performed a risk assessment, and sought professional advice where appropriate in relation to the impact on the future of the business and creditors.

6.4 Conclusion

This chapter has drawn together the analysis of Chapters 2-5 of this dissertation and proposed five resulting recommendations. This dissertation began with two related research questions: first, are non-adjusting creditors of private limited companies sufficiently protected in Thailand? And second, how has the law relating to the protection of non-adjusting creditors of private limited companies in Thailand developed? In this chapter, answers to these questions have been offered on the basis of the analysis conducted in this dissertation. Regarding the first question, using an ESV model of the corporate objective, the sufficiency of protection of non-adjusting creditors is assessed by the extent to which the legal system ensures that shareholders retain their status of residual claimants, not recovering in priority to creditors, and that companies are run ultimately in the interests of creditors when they become the residual claimants. The analysis performed by this dissertation has identified areas in each of the four concepts analysed – legal capital rules, challenging transactions, directors' duties, and shareholder liability – which result in insufficient protection of non-adjusting creditors.

Regarding the second question, the historical analysis of the four conceptual areas reveals that, although influenced in different areas more heavily by English law or German law respectively, in some ways Thai law has followed a different path of development to either English or German law. Overall, Thai law has not developed an objective approach to addressing the problem of asset dilution in relation to connected parties, either through the legal capital regime (German law's approach) or through developing the regime in relation to challenging transactions (English law's approach). In addition, it has not recognised a shift in directors' duties to protect creditors' interests, either through standards of directors' conduct (English law's prevailing approach) or through requirements to seek protection of a formal insolvency regime (German law's prevailing approach). Rather, Thai law's approach focuses on public enforcement by way of specific criminal law provisions, supplemented by the relatively recent innovation of Section 44 of the CCPA in relation to shareholder liability in consumer cases.

From this analysis, in response to the third research question of how to make improvements to the law in this area, this dissertation makes five recommendations. First, it is recommended that Thailand expand the regime in relation to public enforcement, including a regime for director disqualification, using administrative sanctions. Second, it is recommended that directors' duties to act in the interests of creditors when a company encounters financial difficulties should be recognised, in connection with the recommended public enforcement regime. Third, again in connection with the public enforcement regime, it is recommended that company directors be enabled and required to consider initiating formal insolvency proceedings when appropriate, including the consideration of the interests of non-adjusting creditors. Fourth, it is recommended that the mechanism adopted in Section 44 of the CCPA be expanded to all claims for wrongful acts, to confer shareholder liability in cases of bad faith or deceit. Finally, it is recommended that the interpretation of the law relating to dividends be revised, to prevent asset dilution by this means. The advantages and disadvantages of these recommendations have been discussed in this chapter. It is argued that each of these recommendations represents an improvement to the current legal regime for protecting non-adjusting creditors, from an ESV perspective.

CHAPTER 7
CONCLUSION

The problem addressed by this dissertation is the obstacles that non-adjusting creditors of private limited companies in Thailand face in recovering their debts. As discussed in Chapter 1, non-adjusting creditors are conceptualised as a category of creditors, specifically a sub-category of unsecured creditors, who are unable to negotiate the terms on which they extend credit. Non-adjusting creditors may be 'voluntary' creditors, unable to negotiate credit terms due to a lack of bargaining power, for example, or 'involuntary' creditors, such as tort victims, who never chose to become a creditor and had no opportunity to negotiate terms at all.

Non-adjusting creditors face particular risks in relation to recovering debts from private limited companies, particularly when the debtor company encounters financial difficulties. Non-adjusting creditors, by definition, cannot avail themselves of negotiated protections such as taking security over assets of the debtor or through contractual protections such as guarantees. In addition, as unsecured creditors, they are unlikely to make any recovery if the debtor company enters bankruptcy. Furthermore, tensions inherent in the basic structure of the limited company give rise to agency problems: incentives for company insiders – managers and shareholders – to benefit themselves at the expense of creditors. These agency problems, particularly acute in a private limited company in financial difficulties, manifest themselves in three broad categories of behaviour: asset dilution, asset substitution, and debt dilution, discussed in more detail in Chapter 1.

The law offers a range of different mechanisms to protect creditors against the various forms of asset dilution, asset substitution, and debt dilution. These mechanisms may be categorised based on the group of persons targeted: creditor self-protection (unavailable to non-adjusting creditors); legal capital rules, aimed at the capital structure of the debtor company; challenging transactions, aimed at transactions with third parties; directors' duties and obligations to protect creditors' interests, aimed at company managers; and shareholder liability, aimed at company owners. As discussed in Chapter 1, although creditor self-protection deals with all

types of asset dilution, asset substitution, and debt dilution, the other mechanisms address only specific aspects in a piecemeal fashion. As a result, while adjusting creditors may rely purely on the broad techniques of self-protection, non-adjusting creditors must look to the other categories.

Against this background, this dissertation posed two questions for research. First, **are non-adjusting creditors of private limited companies sufficiently protected in Thailand?** In the absence of reliable empirical support for a 'best practice' approach in this area of law, this dissertation approaches this question from a normative standpoint. The ESV approach was selected as the model for evaluation due to the apparent adoption of this model in relation to listed public limited companies by way of the CG2017. The extension of this model to private limited companies is justified by reasons connected with creating consistency across the legal landscape. Under the ESV model, legal strategies have the following legitimate objectives in relation to creditor protection: (i) ensuring that shareholders retain their status as residual claimants; (ii) shifting the objectives of the company to operating in the interests of creditors where they become the residual claimants; and (iii) restricting the ability of companies to engage in asset substitution and debt dilution to benefit shareholders in the short term. These objectives are used to evaluate the legal framework in Thailand, to assess the sufficiency or otherwise of the legal regime protecting non-adjusting creditors.

The second research question is **how has the law relating to the protection of non-adjusting creditors of private limited companies in Thailand developed?** The purpose of asking this question is to allow for the development of nuanced recommendations for the improvement of Thai law. A comparative approach, including both a functional comparison and a historical enquiry, with English and German law, which were influential for many of the relevant provisions in Thai law, is intended to reveal the path of Thai law's evolution and the characteristic approach of Thai law to the protection of non-adjusting creditors. On this basis, in accordance with the third research question, **nuanced recommendations** can be made which are consistent with this characteristic approach, offering the fewest barriers to resistance for their incorporation and implementation within the existing legal framework.

The scope of the research for this dissertation is confined to private limited companies, it does not investigate contractual or proprietary protections, it focuses on the period prior to formal insolvency proceedings, and it generally excludes criminal laws relating to deception. In terms of methodology, the research was primarily documentary although an interview with a representative of the DBD was conducted regarding the feasibility of the dissertation's recommendations, which were revised following the interview. Regarding its academic contribution, this dissertation is the first major work analysing the topic of the protection of non-adjusting creditors and represents a significant addition to English language Thai legal scholarship. As discussed below, Chapters 2–5 address the first two research questions for the four areas of legal mechanisms protecting non-adjusting creditors: legal capital rules, challenging transactions, directors' duties and obligations to protect creditors' interests, and shareholder liability. Chapter 6 offers recommendations based on the analysis of the foregoing chapters, in accordance with the third research question.

Legal Capital Rules

Chapter 2 analysed legal capital rules, which govern the capital structure of the company. Capital maintenance rules, a subset of these rules, concern creditor protection. The essence of these rules is that capital contributed to the company by shareholders should be regarded as available for use while trading but should not (without safeguards) be returned to shareholders prior to liquidation. Capital maintenance rules recognise and uphold the principle of 'shareholders last': ensuring that shareholders do not withdraw capital from the company until creditors have been repaid, i.e. enforcing the concept of the shareholders as the residual claimants, in accordance with the ESV model.

The development of Thai legal rules in this area reveals a bricolage of different sources, although German and Japanese sources are arguably the most influential. The relevant rules may be categorised into those addressing direct and indirect reductions of capital. Direct reductions were further categorised into paying dividends to shareholders, purchasing or redeeming shares directly from shareholders, and engaging in a capital reduction procedure. Although, in contrast to Germany, Thai

law generally addresses indirect reductions of capital through rules on challenging transactions (Chapter 3), there are provisions which require shareholders to pay up share subscriptions in full and prevent the company from cancelling share subscriptions, and a prohibition on setting off calls on shares against debts owed by the company to the relevant shareholder.

The historical and functional comparative analysis reveals that the three jurisdictions took very different evolutionary paths in relation to this concept. Capital maintenance remained central to German law's approach, and it developed broad creditor-protective concepts such as disguised distributions and shareholder loans substituting for equity based on this. English law gradually moved away from reliance on balance sheet tests for capital maintenance, and instead relied increasingly on more flexible standards of directors' conduct. Thai law, by contrast, did not develop in either of these directions but instead relies on a number of criminal offences, using public authorities and the criminal law to ensure compliance. Regarding the evaluation of Thai law against the ESV model, the complete prohibition on share repurchases and redemptions, the requirement to contribute 25% of nominal value on share issuance, and the 10% nominal share value reserve do not fit well with the ESV model since the rules go beyond what this would require. However, only the interpretation of the calculation of the funds available for distribution as dividends presents a potential risk to non-adjusting creditors, as it allows for asset dilution in some circumstances, as described in Chapter 2.

Challenging Transactions

Chapter 3 analysed the second category, rules which allow creditors, or others on their behalf, to challenge transactions made by debtor companies that harm their ability to recover their debts. These include both transactions that result in a net movement of assets away from the company – transactions at an undervalue, or 'fraudulent' transactions – and 'preferential transactions', which result in a particular advantage to one creditor at the expense of others. Both types of transaction constitute asset dilution, from the perspective of the disadvantaged creditors. In all three systems, challenges may be brought either by creditors directly, or by an insolvency office holder on their behalf looking back to the period prior to formal insolvency.

The comparative historical analysis reveals that Thai law in this area was initially influenced by English law, with its focus on fraud prevention, but, due to the manner of the adoption of the CCC, shifted to a position derived from the Roman law *actio pauliana*, with an emphasis on addressing collusion between debtor and counterparty. By contrast to both English and German law, which have over time developed objective tests for challenging transactions (in the case of German law, via legal capital rules), Thai law has retained its subjective test. This results in a position which focuses on penalising only unethical conduct and protecting innocent third parties in the business environment.

From the functional comparative analysis, Thai law arguably does not provide as strong protection for non-adjusting adjusting creditors as English law or German law, when functionally equivalent legal capital rules are taken into account. The Thai legal environment prioritises the protection of honest counterparties over creditors, and arguably incentivises potential counterparties not to investigate the surrounding circumstances where they see a good bargain. This has the advantage of allowing companies in financial difficulties to sell assets at low prices to preserve their liquidity and keep trading. However, it also results in an increased likelihood of asset dilution. Therefore, the rules in this area are not well aligned with the ESV model since it does not strongly address asset dilution or create incentives to preserve value for non-adjusting creditors where a company is in financial difficulties.

Directors' Duties

Chapter 4 analysed the third category, duties imposed by law on those making company decisions and policies, and sanctions for their breach. This broad concept is divided into two categories: duties owed by directors at all times – 'general duties' – and creditor-protective duties which apply when a company encounters financial difficulties, or 'duties to preserve creditors' interests in financial difficulties.' From an ESV perspective, the interests of creditors must be taken into account at all times by directors when making decisions, as one of several stakeholder groups who are impacted by the company. However, since ESV's ordering mechanism ultimately recognises the concept of maximising shareholders' interests, where a company is fully solvent and able to repay debts, creditors' interests are

generally satisfied while there is no likelihood of this position changing. However, when the financial position changes and a company faces a real likelihood of insolvency, creditors become the residual claimants and the directors' duties change: the ESV model recognises a shift in the objective of directors' duties at this point, to act in the interests of creditors.

Regarding the comparative historical analysis, the framework of Thai law differed from English and German law even in the early 20th century, by its emphasis on public enforcement of standards of directors' conduct by way of the criminal law. Over the course of the 20th century, English and German law in this area were generally revised to increase creditor protection through measures requiring directors to file for formal insolvency, legislative changes to directors' duties, judicial recognition of a shift in duties or a direct tortious relationship between directors and creditors. Thai law has retained its approach.

Regarding the evaluation of Thai law against the ESV model, there are significant incompatibilities. There is no recognised shift in directors' duties or recognition that directors must act in creditors' interests. Instead, this concept is addressed through public enforcement via specific criminal provisions in the Offences Act and the BA, which operate to penalise misbehaviour and thus deter directors from acting in ways that represent specific examples of asset dilution, asset substitution, and debt dilution. However, this is not reinforced, as in English and German law, by a regime to disqualify offenders from acting as company directors again in the future.

Shareholder liability

Chapter 5 analysed the final category, imposing liability on shareholders for debts owed by the company. Imposing liability on shareholders removes the incentives for shareholders to pressure management to engage in asset dilution, asset substitution, and debt dilution; however, it also disregards limited liability and separate personality, fundamental features of the company with many benefits for the economy. Shareholder liability is divided into two concepts: piercing the corporate veil – disregarding the separate personality of the company in certain circumstances – and shareholder liability based on control over the company's business, which may result in liability directly to creditors or to the company itself.

The ESV perspective supports rules that disincentivise abusive behaviour on the part of a company's controllers, including shareholders, that prioritises the interests of shareholders over non-adjusting creditors.

Regarding the comparative historical analysis, it appears that the concept of conferring liability on shareholders, particularly in the case of abusive conduct or bad faith, has been present virtually ever since the inception of separate corporate personality and limited liability in Thailand. However, the judicially developed concept of piercing the corporate veil, identified by some academics, has been applied only in extremely rare circumstances. By contrast, Section 44 of the CCPA allows for potentially broad veil-piercing in cases of bad faith or deceit in the consumer context. This approach is distinctively different from English and German law: the former has extended its director liability regime to include shareholders via the concept of 'shadow directors.' By contrast, German law has developed shareholder liability through the tort of destroying the company's existence.

In relation the evaluation of Thai law rules in relation to the ESV model, Section 44 of the CCPA is consistent. However, the shareholder liability framework potentially remains deficient, since this section only applies to consumer cases, protecting only one type of non-adjusting creditor. Outside of businesses likely to be subject to consumer litigation, it seems that shareholders can generally put pressure on directors to make corporate decisions without incurring any additional responsibilities or liabilities. As a result, the law in this area does not align perfectly with the ESV model.

7.1 Results of analysis

Chapter 6 drew together the analysis from Chapters 2–5 to provide answers to the first two research questions and to propose recommendations for improvements to Thai law in this area in accordance with the third research question.

Question 1: Are non-adjusting creditors of private limited companies sufficiently protected in Thailand?

On the basis of the ESV model applied to Thai law, it is possible to conclude that non-adjusting creditors of private limited companies are not sufficiently protected in Thailand. Regarding the first objective of the ESV model, ensuring that shareholders retain their status as residual claimants and do not recover in priority to creditors, there are deficiencies in the legal capital regime which potentially permit capital to be returned to shareholders in breach of the concept of shareholders' last and the regime relating to challenging transactions arguably emphasises flexibility for debtor companies and protection of third parties, potentially incentivising companies to engage in asset dilution harmful to non-adjusting creditors. Regarding the second ESV objective of shifting the objectives of the company when creditors become the residual claimants, Thai law has a potentially deficient regime for incentivising directors to act in the interests of creditors, both in relation to the duties imposed on the directors by law and also in the regime conferring liability on shareholders. Furthermore, regarding the final objective of restricting the ability of companies to engage in asset substitution and debt dilution, Thai law again has deficiencies: the legal framework focuses on a relatively small number of specific criminal offences, generally aimed at directors, to prevent abuse in this area.

Question 2: How has the law relating to the protection of non-adjusting creditors of private limited companies in Thailand developed?

As discussed in detail in Chapter 6, Thai law has developed in a different path to both of the comparator jurisdictions. It has not developed an objective approach to addressing the problem of asset dilution, either through legal capital rules or through the framework for challenging transactions, for example. In addition, it has not recognised a shift in directors' duties to protect creditors' interests prior to formal insolvency, including, for example, a requirement to seek protection of a formal insolvency process. Overall, the protection of non-adjusting creditors appears primarily achieved by way of public enforcement of criminal law, supplemented by the relatively recent innovation of privately enforced shareholder liability in the case of bad faith in the consumer context. As a result, it follows that recommendations for

improving the protection of non-adjusting creditors through developing the public enforcement regime would fit with Thai law's path of development in this area, addressing the deficiencies identified by way of the analysis against the ESV model.

7.2 Recommendations

Pursuant to the third research question, the recommendations for improvement of Thai law, detailed in Chapter 6, may be summarised as follows:

1. Public enforcement of directors' duties and director disqualification regime. This would include automatic disqualification of directors on the commission of certain criminal offences, disqualification by the court for repeated abusive behaviour, and administrative sanctions to be imposed by the DBD for abusive behaviour prior to insolvency. This recommendation addresses weaknesses in the challenging transactions and directors' duties regimes.

2. Recognition of directors' duties to act in the interests of creditors. Such duties would be taken into account in the public enforcement regime in Recommendation 1. This recommendation also addresses weaknesses in the challenging transactions and director's duties regimes.

3. Empowering and requiring company directors to initiate formal insolvency proceedings when appropriate, including consideration of non-adjusting creditors. This addresses the weakness in the directors' duties regime of a lack of a shift to contemplate an insolvency procedure to protect creditors' interests.

4. Expanding CCPA approach beyond consumers. This expansion, to include all wrongful acts, addresses weaknesses in the shareholders' liability regime which result in incentives that run contrary to the ESV model.

5. Revising the interpretation of the law relating to dividend distributions. This addresses weaknesses in the current regime relating to the legal capital reserve which, as argued, is ineffective, inefficient and lacks normative justification.

The details, advantages, disadvantages and method of implementation of the recommendations are set out in Chapter 6.

7.3 Limitations and areas for further research

The research performed for this dissertation was subject to certain limitations. First, research into German law was performed primarily through English language publications since the author does not read German. Although there are a wide range of English language publications available on German law, it must be acknowledged that the findings may have been different from a review of a wider range of sources in the original language was performed. Second, this dissertation compared Thai law with English law and German law, on the basis that these laws were heavily influential on the drafting of Thai company and bankruptcy laws. However, it should be acknowledged that the laws of other jurisdictions were influential, notably Japanese law. Comparison against this legal system was not included primarily due to the lack of sufficient and available resources in English and because the author does not read Japanese. Finally, the research performed for this dissertation was restricted in scope to private limited companies, on the basis that the agency conflict impacting non-adjusting creditors is theoretically most acute in the context of a close relationship or overlap between shareholders and managers, typically the case in private limited companies. However, it must be acknowledged that the recommendations made here, if adopted, may cause some divergence between the business forms of private limited companies and public limited companies. Therefore, analysis of whether the recommendations, particularly public enforcement and the interpretation of directors' duties, are applicable to the public limited company regime is identified as an area for further research.

The results of this dissertation indicate several areas for further research. First, as described above, similar research could be performed in relation to other business vehicles in Thailand which benefit from limited liability: public limited companies, as mentioned above, both listed and unlisted, and limited partnerships, for example. Second, a recommendation for a public enforcement regime including director disqualification opens the possibility for applying this regime in respect of other criminal activities that go beyond the scope of this dissertation, for example deliberately deceptive and fraudulent acts, and acts which violate anti-money laundering legislation, for example. In addition, addressing some of the limitations identified above, comparison could be made with other legal systems including Japanese law. Other legal systems, particularly those in Asia, could also be used as comparator legal systems to identify additional weaknesses in the present Thai regime and to offer other potential improvements. Finally, this dissertation has focused on the written law and its interpretation by courts and academics. Further research could focus on aspects of legal culture and the interaction between law and society, such as the perception of the current legal framework regarding the protection of non-adjusting creditors, its strengths and weaknesses, and the extent to which creditors should be protected, by those who work within and are affected by the issues which are the subject of this dissertation. In addition, empirical research could be undertaken to identify the impact of business failure on non-adjusting creditors in Thailand, which would further inform the recommendations made here.

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APPENDICES

APPENDIX 1

Legal Execution Department Bankruptcy Statistics

Statistics of enforcement of bankruptcy cases entered by juristic persons

Year	Number of cases	Amount of debt submitted (THB)
2017	1,053	111,663,618,266.68
2018	886	138,144,169,331.86
2019	919	122,236,719,029.68

APPENDIX 2

Table of Sources of Creditor Protection Provisions

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
Legal Capital – direct reductions				
1201 para 3 CCC	No dividend shall be paid otherwise than out of profits. If the company has incurred losses, no dividend may be paid unless such losses have been made good.	German: Com s.215 English: CCA Sch1 Para 97 Others: Ch B.C.B. 31	**English** CCA 1908: "No dividend shall be paid otherwise than out of profits." **Japanese** Commercial Code A.195: "A *société anonyme* cannot distribute profits unless losses have been made good and the amount of the sinking fund mentioned in A. 194 par. 1 has been set aside."	English and Japanese sources
1202 CCC	The company must appropriate to a reserve fund, at each distribution of dividend, at least one-twentieth of the profits arising from the business of the company, until the reserve fund reaches one-tenth part of the capital of the company or	French: Loi1867 36 German: Com 262(1) Swiss: SO 634, 656 Japanese: Com 194-5 Others: Greece 5 June 1920; Hungary Com 199;	**Japanese** Commercial Code A.194: "Whenever profits are distributed, the association shall set apart one twentieth of such profits as a sinking fund until it amounts to one fourth of the capital.	German and Japanese sources

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	such higher proportion thereof as may be stipulated in the regulations of the company. If shares have been issued at a value higher than the face value, the excess must be added to the reserve fund until the latter has reached the amount mentioned in the forgoing paragraph.	Baudry XV Nos 2517-8 p.214; Siam 340(2) 326	Where shares have been issued above the nominal value, the excess amount shall be added to the sinking fund until it amounts to one fourth of the capital. **German** Commercial Code 262(1): A reserve fund must be created to cover any loss which may appear upon the balance sheet. To the credit thereof must be placed: (1) At least one twentieth part of the net profits for each year so long as the reserve fund does not exceed one tenth part of the capital of the company or such higher proportion thereof as may be stipulated in the memorandum of association.	
19 Offences Act	Any limited company which pays dividends in contravention of section 1201 of the Civil and Commercial Code or distributes dividends in contravention of	No List of Foreign Sources. [Similar to Section 289 of the Partnerships and Companies Act of 1911]	**Japanese** Commercial Code A.262(7): Article 262. Promoters, members managing the business of a business association, directors,	Japanese source for first paragraph. No apparent foreign source for second paragraph.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	section 1202 of the Civil and Commercial Code shall be liable to a fine not exceeding [twenty thousand Baht]. Any sum, other than the amount paid on shares, paid or distributed to shareholders as such shall be deemed as the dividend under this section.		representatives of foreign business associations, auditors, or liquidators are punished by a fine of from ten yen to one thousand yen in the following cases: 7. When they omit to set apart a sinking fund in violation of the provisions of Art. 194 or make distributions in violation of the provisions of Art. 195, par. 1, or Art. 196.	
1143 CCC	A limited company may not own its own shares or take them in pledge.	German: Com. 226 Japanese: Com. 151 English: CCA First Sched 8	**Japanese** Commercial Code A.151: A *société anonyme* shall not acquire or take as security its own shares.	Japanese source. English and German sources are similar, although the German source contains exceptions and the English source forms part of model company articles.
12 Offences Act	Any limited company which owns its own shares or takes its own shares in pledge in contravention of section 1143 of the Civil and	No List of Foreign Sources. [Similar to Section 285 of the Partnerships and Companies Act of	**Japanese** Commercial Code A.262(4): Article 262. Promoters, members managing the business of a	Japanese source.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	Commercial Code shall be liable to a fine not exceeding [one hundred thousand Baht].	1911]	business association, directors, representatives of foreign business associations, auditors, or liquidators are punished by a fine of from ten yen to one thousand yen in the following cases: 4. When they acquire shares or take them as security or cancel shares, in violation of the provisions of Art. 151.	
1224 CCC	1224. A limited company may, by special resolution, reduce its capital either by lowering the amount of each share or by reducing the number of shares.	French: Loi1867 48,49 German: Com. 288, 290 Swiss: SO 626, 670 Japanese: Com. 151, 220 English: CCA 48 Others: Ch B.C.B. 27 [virtually identical to s.228 of Partnerships and Companies Act 1911 – similar wording in charters]		German and English requirements for special resolution. Otherwise, wording is most similar to Partnerships and Companies Act of 1911 and charters of earlier Siamese charter companies.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
1225 CCC	1225. The capital of the company may not be reduced to less than one-fourth of its total amount.	Others: Ch B.C.B. 27 [virtually identical to s.229 of Partnerships and Companies Act 1911 – no such wording in charter, despite reference]		No apparent foreign source; appears in Partnerships and Companies Act 1911.
1226 CCC	1226. When a company proposes to reduce its capital, it must be published [once] at least in a local paper and send to all creditors known to the company a notice of the particulars of the proposed reduction, requiring the creditors to present within [30 days] from the date of such notice any objection they may have to such reduction. If no objection is raised within the period of [30 days], none is deemed to exist. If no objection is raised, the	German: Com. 289(3) Japanese: Com. 79, 220 English: CCA 49 Others: Ch B.C.B. 28 [virtually identical to s.230-1 of Partnerships and Companies Act 1911 – similar wording in charters]	**Japanese:** Commercial Code A.78: "The association must publicly announce to its creditors within this period that they may present their objections within a certain time, and if the creditors are known to the association, they must be separately notified. But the time within which they may present their objections shall not be less than two months. 79. If creditors make no objections against the consolidation or absorption within the time	The wording is similar to the Japanese source, although the time requirements and numbers of publications are not. The time requirements are the same as in the Partnerships and Companies Act of 1911 and in charters of earlier Siamese charter companies, however there is no apparent foreign source for these.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	company cannot proceed with the reduction of its capital unless it has satisfied the claim or given security for it. [Amendments from 7 times to once, and from 3 months to 30 days made by Section 13 of CCC Amendment Act (No 18) BE 2551		mentioned in Art. 78 par 2, they are considered to have consented to it. If creditors make objections, the consolidation or absorption cannot take place unless the debts are paid or adequate security is furnished."	
22 Offences Act	Any limited company which fails to publish or send a notice indicating the proposal to reduce its capital in accordance with section 1226 paragraph one of the Civil and Commercial Code or proceeds with a reduction of its capital in contravention of section 1226 paragraph three of the Civil and Commercial Code shall be liable to a fine not exceeding [fifty thousand Baht].	No List of Foreign Sources. [No similar provision in Partnerships and Companies Act of 1911]	**Japanese**: Commercial Code A.262(2): "Promoters, members managing the business of a business association, directors, representatives of foreign business associations, auditors or liquidators are punished by a fine from ten yen to one thousand yen in the following cases: 2. When they carry out a consolidation, a disposition of property of the association, a	Japanese source. No similar provisions in English or German sources.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
			reduction of the capital or an alteration of its association in violation of the provisions of Arts. 78-80.	
Legal capital – Indirect reductions				
1105 CCC	Shares may not be issued at a lower price than their nominal amount. The issue of shares at a higher price than their nominal amount is permissible, if sanctioned by the memorandum. In such case the excess amount must be paid together with the first payment. The first payment on the shares must not be less than twenty-five per cent of their nominal amount.	French: Iacour I 427, 428 Japanese: Com. 128, 129	**Japanese**: Commercial Code A.128-9: "128. The value for which the shares are issued must not be less than the face value. The amount of the first payment must not be less than one quarter of the amount of the shares. 129. When all the shares have been taken, the promoters must without delay cause the first payment to be made upon each share. When shares are issued above the face value, the promoters must cause the excess amount to be paid together with the first payment.	Japanese source, although this in turn is almost identical to s.184 of the German Commercial Code.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
1120 CCC	Unless otherwise decided by a general meeting, the directors may make calls upon the shareholders in respect of all money being due on their shares.	English: CCA 1st Schedule 12	**English**: CCA 1st Schedule 12: "The directors may from time to time make calls upon the members in respect of any moneys unpaid on their shares, provided that no call shall exceed one-fourth of the nominal amount of the share, or be payable at less than one month from the last call; and each member shall (subject to receiving at least fourteen days' notice specifying the time or times of payment) pay to the company at the time or times so specified the amount called on his shares.	English source, although the qualification 'unless otherwise decided by a general meeting' does not appear here, and the concept is not present in the other foreign sources.
1114 CCC	After a company is registered, a subscriber of shares cannot enter a claim for cancellation by the Court of his subscription on the ground of, mistake, duress or fraud.	German: Com. 213 Swiss: 629	German: Commercial Code s.213: "Shareholders have not the right to demand the repayment of their contributions to capital; as long as the company remains in existence, they have no claim except upon the net profits of the company, in so	German and Japanese sources: although not referred to in the List of Foreign Sources, the Japanese Commercial Code refers, like the CCC, specifically to fraud and duress unlike the German source.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
			far as the division of these is not prohibited by law or by the memorandum of association" [Japanese: Commercial Code A. 142: "No subscriber shall be allowed to rescind his subscription on the ground of fraud or duress after a company has been registered at the place of its principal office according to the provisions of A 141 par 1."]	
41 Offences Act	Any person who, being responsible for the operation of affairs of a registered partnership, limited partnership or limited company, does any act or omits to do any act, with an intent to seek any benefit otherwise unobtainable by a lawful means for himself or for any other person and thereby causes loss to such juristic person shall be liable	No List of Foreign Sources.	**German**: Commercial Code s.312: "Members of the directorate or board of supervision or liquidators, in the event of their wilfully acting to the disadvantage of the company, are punishable by imprisonment and simultaneously by a fine not exceeding M. 20,000"	German source: conceptually similar, although wording is different.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	to a fine not exceeding [fifty thousand Baht].			
48 Offences Act	Any person who dishonestly fixes the value of the service or property as a contribution to a registered partnership, limited partnership or limited company in lieu of money payable on shares in an amount higher than its actual value shall be liable to a fine not exceeding [fifty thousand Baht].	No List of Foreign Sources.	**German**: Commercial Code s.313: "(1) Promoters or members of the directorate or board of supervision who, for the purposes of the entry of the company in the Mercantile Register, knowingly give false information in respect of the subscription or payment of the original capital, the price at which the shares were issued, or arrangements of the description specified in sect. 186"	German source: conceptually similar, although wording is different.
1119 Para 2 CCC	A shareholder cannot avail himself of a set-off against the company as to payments on shares.	Japanese: Com. 135, 144(2) Other: Ch B.C.B 12	**Japanese**: Commercial Code A.144(2): "As to payment on shares, a shareholder cannot claim a set-off against the association" **German**: Commercial Code s.221: "Shareholders and their predecessors in title cannot be	Japanese and German sources.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
			released from their obligations to make payments arising out of the provisions of sects. 211 and 220. They cannot set-off a debt due from the company against such obligations."	
Challenging transactions				
237 CCC	The creditor is entitled to claim cancellation by the Court of any juristic act done by the debtor with knowledge that it would prejudice his creditor; but this does not apply if the person enriched by such act did not know, at the time of the act, or the facts which could make it prejudicial to the creditor, provided, however, that in case of a gratuitous act the knowledge on the part of the debtor alone is sufficient. The provisions of the foregoing	1923 Code: 409 Japanese Civil Code: 424 Italian Code: 1239	**Japanese**: Civil Code A.424: "The creditor may demand the court to cancel any juristic act done by the debtor with knowledge that it would prejudice his creditor; but this does not apply if the person enriched by such juristic act or a subsequent acquirer did not know, at the time of the act or of the acquisition, of the facts which would make it prejudicial to the creditor. The provisions of the foregoing paragraph do not apply to a juristic	Japanese source

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	paragraph do not apply to a juristic act whose subject is not a property right.		act whose subject is not a property right."	
238 CCC	The cancellation under the foregoing section cannot affect the right of a third person acquired in good faith. The foregoing paragraph does not apply if the right is acquired gratuitously.	Italian Code: 1235		The stated source is not similar to the first paragraph or the wording of the second, although it contains the concept that collusion of both parties is not required if the right is acquired gratuitously, which is common in systems tracing their origin back to Roman law.
239 CCC	Cancellation operates in favour of all the creditors.	1923 Code: 412 Japanese Civil Code: 425	**Japanese**: Civil Code A.425: "A cancellation made according to the previous article has effect for the benefit of all the creditors."	Japanese source.
240 CCC	A claim for cancellation cannot be brought later than one year from the time when the creditor knew of the cause of cancellation, or later than ten years since the act was done.	1923 Code: 413-4 Japanese Civil Code: 426	**Japanese**: Civil Code A.426: "The right of cancellation mentioned in Art. 424 is extinguished by prescription if the creditor does not exercise it for two years from the time when he had notice of the cause of cancellation. The same	Japanese source, although time periods are reduced by half.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
			applies if twenty years have elapsed since the time of the act."	
113 BA	The receiver may apply, by motion, to the Court for cancellation of fraudulent acts in accordance with the Civil and Commercial Code	No List of Foreign Sources	No apparent foreign source	No apparent foreign source.
114 BA	If the juristic act intended to be cancelled on the ground of fraud under section 113 arose during the period of one year before the bankruptcy petition and thereafter or constitutes a gratuitous act or constitutes an act under which the debtor has received unreasonably small remuneration, it shall prima facie be presumed to be an act whereby the debtor and the person enriched thereby knew that it would be prejudicial to the creditor	No List of Foreign Sources	No apparent direct foreign source. However, its predecessor, s.45 of the Bankruptcy Act R.S. 130 had a two year twilight period where transactions could be challenged unless made honestly and for good value. This appears modelled on s.47 of the English Bankruptcy Act 1883, which contains similar wording.	No apparent direct foreign source, but its Thai legislative predecessor seems to have been based on English law.
115 BA	In the event of a transfer of	No List of Foreign Sources	No apparent direct foreign source.	No apparent direct foreign source,

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	property or any act done by the debtor or done with the debtor's consent during the period of three months before the bankruptcy petition and thereafter with the intent to enable any creditor to have an advantage over other creditors, the Court has the power to, upon the Receiver's application by motion, order a cancellation of such transfer or such act. If the creditor who has become advantaged is the debtor's insider, the Court has the power to order a cancellation of such transfer or such act under paragraph one as done during the period of one year before the bankruptcy petition and thereafter		However, its predecessor, s.46 of the Bankruptcy Act R.S. 130 had a two year twilight period where transactions could be challenged unless made honestly and for good value. This appears modelled on s.48 of the English Bankruptcy Act 1883, which contains similar wording.	but its Thai legislative predecessor seems to have been based on English law.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
116 BA	The provisions of section 115 is not prejudicial to rights of third persons acquired in good faith and for value before the bankruptcy petition.	No List of Foreign Sources	No apparent direct foreign source. However, its predecessor, s.46 of the Bankruptcy Act R.S. 130 had a two year twilight period where transactions could be challenged unless made honestly and for good value. This appears modelled on s.48 of the English Bankruptcy Act 1883, which contains similar wording.	No apparent direct foreign source, but its Thai legislative predecessor seems to have been based on English law.
Directors' duties				
1167 CCC	The relations between the directors, the company and third persons are governed by the provisions of this Code concerning Agency	French: Com 32 German: Com 302; 241 Swiss: 654, 667, 673, 674 Japanese: 170, a77 [Wording similar to Section 168 of the Partnerships and Companies Act 1911.]	**Japanese**: Commercial Code A.170: "Each director represents the association. The provisions of A62 are applicable to directors." [A62 - A representative member of the association has authority to do all acts in court or outside of court	Japanese and German sources have similar concepts, however the wording does not appear to be directly taken from any of the specified foreign sources. Similar, also, to the Partnerships and Companies Act 1911.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
			in regard to the business of the company] **German**: Commercial Code s.231 para 1 and 235 para 2: "For the purpose of all judicial and extra-judicial transactions, the company is represented by the directorate… …As against third parties a limitation of the powers of the directors to act on behalf of the company is inoperative."	
1168 CCC	The directors must in their conduct of the business apply the diligence of a careful business man. In particular, they are jointly responsible: (1) For the payment of shares by the shareholders being actually made;	French: Lacour Vol I. No.547 Note (2) German: Com 241, 236 Swiss: 55 Japanese: Com 175 para 1 English: [CCA?] Sect 76 Other: c/p Book I and II	**German**: Commercial Code s.241: "The directors must in their conduct of the business apply the diligence of a careful business man." Commercial Code s.236: "The directors may not without consent of the company either	German source for para 1, German and Japanese sources for para 3. The list style in para 2 is similar to German 241, but the items in the list are different.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	(2) For the existence and regular keeping of books and documents prescribed by law; (3) For the proper distribution of the dividend or interest as prescribed by law; (4) For the proper enforcement of the resolutions of the general meetings. A director must not, without the consent of a general meeting of shareholders, undertake commercial transactions of the same nature as and competing with that of the company, either on his own account or that of a third person, nor may he be a partner with unlimited liability in another commercial concern carrying on a business of the same nature as and competing with that company.		carry on a mercantile trade or do business for their own account or for that of a third party in the same branch of commerce as the company, nor may they be interested in a mercantile partnership as general partners. The power to grant such consent rests with the body by whom the directorate is appointed." **Japanese**: Commercial Code A.175: "A director without the consent of the general meeting of shareholders cannot carry on commercial transactions within the scope of a business association or become a member of unlimited liability of any other business association doing the same business either on his own account	

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	The foregoing provisions also apply to persons representing the directors.		or on account of third parties."	
1169 CCC	Claims against the directors for compensation for injury caused by them to the company may be entered by the company or, in the case the company refuses to act, by any of the shareholders. Such claims may also be enforced by the creditors of the company in so far as their claims against the company remain unsatisfied.	French: Loi 1876 17, 39 German: Com 268, 269, 241 Swiss: 673, 674 Japanese: Com 178 Other: c/p Book I and II Sect.233 [Paragraph 1 very similar to Section 170 of the Partnerships and Companies Act 1911]	No apparent direct foreign source for para 1. **German**: Commercial Code s.241 para 3: "In the cases specified in the foregoing paragraph a right to compensation can be enforced by the company's creditors as well, in so far as their claims remain unsatisfied by the company."	No apparent direct foreign source for para 1. Conceptually similar to all stated sources but different requirements. Similar to Section 170 of the Partnerships and Companies Act 1911. German source for para 2.
40 Offences Act	Any person who, being responsible for the operation of affairs of a registered partnership, limited partnership or limited company, does any of the following acts	No List of Foreign Sources	No apparent direct foreign source; no analogous provisions in Partnerships and Companies Act 1911.	No apparent foreign source. Appears only at adoption of Offences Act, not in previous legislation.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	knowingly that the creditor of such juristic person or the creditor of any other person intending to exercise the right of the creditor of such juristic person enforces the debt against such juristic person or brings or is likely to bring an action before a Court to claim payment of a debt: (1) diverting, concealing or transferring to any other person the property of such juristic person; or (2) pretending that such juristic person is in debt, which is untrue, shall be, if the act is committed to prevent the creditor from receiving full or partial payment, liable to imprisonment for a term not exceeding [3 years] or to a fine not exceeding [sixty thousand baht] or both.			

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
41 Offences Act	Any person who, being responsible for the operation of affairs of a registered partnership, limited partnership or limited company, does any act or omits to do any act, with an intent to seek any benefit otherwise unobtainable by a lawful means for himself or for any other person and thereby causes loss to such juristic person shall be liable to a fine not exceeding [fifty thousand Baht].	No List of Foreign Sources.	**German**: Commercial Code s.312: "Members of the directorate or board of supervision or liquidators, in the event of their wilfully acting to the disadvantage of the company, are punishable by imprisonment and simultaneously by a fine not exceeding M. 20,000" [No similar provision appears in Partnerships and Companies Act 1911]	German source: conceptually similar, although wording is different.
164 BA	During the period of one year prior to a petition requesting that the debtor be adjudged bankrupt and thereafter bur prior to a receivership order, any debtor who does any of the following acts shall be liable to a fine not exceeding one thousand Baht or to	No List of Foreign Sources	**English**: Bankruptcy Act 1914 s.154 (although similar provisions in many English Acts, essentially repeating wording from Debtors Act 1869): "Any person who has been adjudged bankrupt or in respect of whose estate a receiving order has	English source, although the wording is altered somewhat from the source. Note that the English provisions only apply to individuals, not to companies: offences in relation to company directors have a different (and smaller) scope.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	imprisonment for a term not exceeding two years or to both: (1) diverting, hiding, destroying, damaging or altering seals, account books, or documents relating to his business or property or conniving at such act, unless an absence of an attempt to conceal the nature of his affairs is proven; provided that if seals, account books or documents are lost, damaged or altered, it shall prima facie be presumed that the debtor is the perpetrator; (2) omitting to record material statements or recording false statements in account books or documents related to his business or property or conniving at such omission or action; (3) pledging, mortgaging or disposing of any property which		been made shall in each of the cases following be guilty of a misdemeanour: … (9) If, after the presentation of a bankruptcy petition by or against him, or within six months next before such presentation, he conceals, destroys, mutilates, or falsifies, or is privy to the concealment, destruction, mutilation or falsification of any book or document affecting or relating to his property or affairs, unless he proves that he had no intent to conceal the state of his affairs or defeat the law; (10) If, after the presentation of a bankruptcy petition by or against him, or within six months next before such presentation, he makes or is privy to the making of any false entry in any book or	

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	has been acquired on credit and the price of which has not yet been paid for, unless such act is in the course of the debtor's ordinary business and the absence of any fraudulent intent is proven; (4) taking a loan from any other person by deceit or concealing, transferring or delivering his property dishonestly or causing or allowing any other person to cause his property to be encumbered dishonestly or allowing himself or conspiring with any other person to allow himself to be ordered by the Court to pay any debt which he should not be liable to pay.		document affecting or relating to his property or affairs, unless he proves that he had no intent to conceal the state of his affairs or defeat the law; … (15) If, within six months next before the presentation of a bankruptcy petition by or against him, or, in the case of a receiving order made under section one hundred and seven of this Act, before the date of the order, or after the presentation of a bankruptcy petition and before the making of a receiving order, he pawns, pledges or disposes of any property which he has obtained on credit and has not paid for, unless, in the case of a trader, such pawning, pledging or disposing is in the ordinary way of his trade,	

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
			and unless in any case he proves that he had no intent to defraud; 156 If any person who has been adjudged bankrupt or in respect of whose estate a receiving order has been made (a) in incurring any debt or liability has obtained credit under false pretences, or by means of any other fraud : (2) with intent to defraud his creditors, or any of them, he has made or caused to be made any gift, or transfer of or any charge on his property; (3) with intent to defraud his creditors, has concealed or removed any part of his property since or within two months before the date of any unsatisfied judgment or order for payment of	

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
			money obtained against him. [per 158(4), the time limits are extended to 2 years in the case of books of account in relation to trading]	
166 BA	Any debtor, having indebtedness in consequence of trade or business at the time of receivership, who does any of the following acts shall be liable to a fine not exceeding five hundred Baht or to imprisonment for a term not exceeding one year or to both: (1) at an interrogation by the Receiver or an inquiry by the Court, failing to give justifiable reasons for the loss of a large amount of property during the period of one year prior to a bankruptcy petition or thereafter but prior to the receivership order;	No List of Foreign Sources	**English**: Bankruptcy Act 1914 s.157: "Any person who has been adjudged bankrupt, or in respect of whose estate a receiving order has been made, shall be guilty of a misdemeanour if, having been engaged in any trade or business, and having outstanding at the date of the receiving order any debts contracted in the course of and for the purpose of such trade or business, … (c) On being required by the Official Receiver at any time, or in the course of his public	English source, although the wording is altered somewhat from the source. Note that the English provisions only apply to individuals, not to companies: offences in relation to company directors have a different (and smaller) scope.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	(2) creating a debt of which repayment can be applied for in a bankruptcy action, without any cause to believe in the prospect of it being paid.		examination by the court, to account for the loss of any substantial part of his estate incurred within a period of a year next preceding the date of the presentation of the bankruptcy petition, or between that date and the date of the receiving order, he fails to give a satisfactory explanation for the manner in which such loss was incurred… (a) in incurring any debt or liability has obtained credit under false pretences or by means of any other fraud.”	
173 BA	Any person who, knowing of the receivership order or the would-be receivership order, diverts, conceals, takes, disposes of or manages the debtor’s property dishonestly shall be liable to a fine not exceeding two times the value	No List of Foreign Sources	No apparent foreign source.	No apparent foreign source.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	of such property or to imprisonment for a term not exceeding two years or to both. For the purpose of this section, it shall prima facie be presumed that when the Receiver has published a receivership order in the Government Gazette and in a daily newspaper every person has had the knowledge of such order.			
Shareholder liability				
1096 CCC	A limited company is that kind which is formed with a Capital divided into equal shares, and the liability of the shareholders is limited to the amount, if any, unpaid on the shares respectively held by them.	French: Com 29, 30, 33, 34, Loi 1867 21(3) German: Com 178 Swiss: 612, 633 Japanese: Com. 143-5 English: CCA 2 Misc: It. Com. 76, 77 [Provision similar to Section 87 of the Partnerships and Companies	**Japanese**: Commercial Code 143 "The capital of a joint stock company must be divided into shares. The liability of a shareholder is limited to the amount of shares taken or acquired by him."	The most similar foreign source is the Japanese commercial code, although the provision is also conceptually and structurally very similar to the equivalent section in the Partnerships and Companies Act 1911

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
		Act 1911]		
44 CCPA	In a case which a Business Operator against whom the legal action is brought is a juristic person, if it appears that such juristic person is incorporated or acts in bad faith, or has a deceitful behaviour against Consumers, or there is an embezzlement of the juristic person's property to become beneficial to any person, and the juristic person's property is insufficient to satisfy the obligation as per the plaint, upon the request of a party, if the Court thinks fit, the Court shall have the power to summon partners, shareholders, or person having the power to control the operation of the juristic person, or the person receiving property from such juristic person to be the joint defendant, and shall have the	No List of Foreign Sources	From drafting notes to the Act, appears to place the judicially developed concept of piercing the corporate veil on a statutory footing to address obstacles facing consumers in bringing cases against businesses.	No apparent foreign source.

Provision	Wording	List of Foreign Sources	Likely Source Wording	Conclusion on Likely Sources
	power to adjudicate that such persons be jointly liable for the obligation owed to the Consumer, unless such person proves his or her innocence in such act, or in case of person receiving property from such juristic person, proves that he or she acquires the property in good faith and for value.			

APPENDIX 3

Interview Summary – Expert from SEC

<u>Summary of interview</u> between Adam Reekie ("Interviewer") and Thawatchai Pittayasophon, Deputy Secretary-General of the Office of the Securities and Exchange Commission ("Interviewee")

Time and date of interview: 10:00am, Tuesday 4 April 2023; interview conducted online via video conference

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Introduction

The background of the research was briefly explained by the Interviewer, and the purpose of the interview was explained as to gather further information from an expert regarding concepts concerning the Corporate Governance Code 2017 ("**CG2017**") and whether the view of the corporate purpose in the CG2017 could be seen as a best practice approach to corporate governance, to be implemented generally, including in respect of private limited companies.

The Interviewee briefly described his experience on the legal side and stated that his views were an expression of his personal opinion and should not be taken as representing the official opinion of the SEC or any other agency.

Question 1: Can the CG2017 be seen as a statement of best practice principles that can also be applied to private limited companies?

<u>Reply</u>

The hard law requirements regarding corporate governance were created primarily by the amendments to the Securities Exchange Act BE 2535 (1992) ("SEA") in 2008, specifically in Chapter III/I which deals with governance of publicly traded public limited companies.

The soft law is created by the Corporate Governance Code, the latest version of which is the CG2017. The connection between the hard law and the soft law is the hard law requirement to disclose the extent to which the company has applied the CG2017's requirements in its annual registration statement: the 'one report' under Section 56 paragraph 1 of the SEA. Clearly therefore this does not apply to private limited companies, which are not required to disclose this information.

However, in the Interviewee's personal view, in respect of situations where there is some kind of impact to other stakeholders – employees, customers, society, the economy – it is possible to apply the principles in the CG2017 as best practice for private companies also.

Question 2: Regarding Principle 5.3 and the Introduction to the CG2017, does this represent an enlightened shareholder value approach to the corporate objective? Would this support a shift towards a company acting in the interests of creditors when it encounters financial difficulties?

Reply

In relation to publicly traded companies, Section 89/22 of the SEA imposes on the plan preparer and plan administrator in business rehabilitation under the Bankruptcy Act BE 2483 (1940), *mutatis mutandis*, the fiduciary duties that apply to directors under Chapter III/I. In the Interviewee's opinion, this is therefore clearly best practice as regards listed companies, but it is also reasonable to consider that it is best practice for private limited companies to consider the interests of creditors.

The Interviewee does not express the opinion that all the principles of the CG2017 are applicable to private limited companies, since individually they have less impact to society (e.g. in terms of the number of their shareholders). However, it should be further studied as to which principles should also be applied to private limited companies.

Question 3: Traditionally, directors were only required to consider the interests of the shareholders of their company, at least until formal bankruptcy proceedings are

initiated. However, in the CG2017 there is a requirement to consider the interests of other groups of people. Should this also be the case for private limited companies?

Reply

In the Interviewee's view, they should consider other stakeholder groups. For example, for reasons of sustainability. If you only focus on shareholders' interests, in the context of private limited companies, it is not likely that you would be able to operate a business in a sustainable way. The interests of customers, employees, etc. should be considered. They all cooperate to build the success of a business. The difficulty is how to analyse this and put together the principles in a practical manner, as well as the question of how to persuade directors to consider these concepts in practice. This will depend on the progress of the business as to how much they can look at other stakeholders or interest groups and still allow their business to survive.

Question 4: One of the proposals of the research is to create administrative sanctions for misbehaving directors, in relation to the conduct of directors in the period before bankruptcy, including director suspension and director disqualification for those breaching their duties. Does the Interviewee think this would be consistent with the view of the corporate purpose and the best practice principles of the CG017?

Reply

The Interviewee agrees with this proposal. The SEC applies administrative sanctions on directors and senior officers, and personnel providing services in the capital markets as well. Some of these relate to prohibited characteristics or having some kind of involvement in fraudulent schemes or other misconduct, or having committed serious offence as determined by relevant notifications which bars them from serving as directors of listed companies. The SEC therefore applies these kinds of rules in relation to the capital market. Clearly this will depend on how misconduct is defined.

Question 5: The proposed regime is based loosely on the administrative sanctions regime in the Trust for Transactions in the Capital Markets Act BE 2550 (2007), with some changes. Would this be an appropriate model?

Reply

These kinds of provisions can also be found in the Derivatives Act as well. However, these are not the only two Acts: see also the SEA and the Emergency Degree on Digital Assets Businesses. Therefore, this is quite a common concept among several Acts.

- End -

APPENDIX 4
Interview Summary – Expert from DBD

Interview summary[1]
Mr Kittisak Chotpanichsate, Special Commercial Academic Expert, Department of Business Development, Ministry of Commerce
Wednesday, 23 February 2022, 13.30 – 15.30
With Assistant Professor Adam Reekie
Interpreter: Assistant Professor Dr Surutchada Reekie

1. Overall, what is your opinion on the issue of protection for unsecured creditors of private limited companies in Thailand? Are there any issues that should be addressed urgently? And what role should the Department of Business Development play?

Reply

In practice, the main task of the Department of Business Development is registration. Therefore, there is no direct duty to protect creditors. However, if I am asked my opinion on whether there should be protection, my answer is that I agree with this, in principle. The reason for this is that those who borrow must repay their debts, and Thai law has distinctions between different levels of creditors with the result that unsecured creditors receive the least amount of protection.

However, it is not clear what the standards of protection should be, and how they should be achieved, since this will have an impact on the other groups of creditors.

2. Do you agree with the following proposals, and why or why not, and in your opinion are these proposals genuinely practical or not?

[1] English translation by the author of the Thai original version, written by Dr Surutchada Reekie, included below.

- The insolvency office holder will be required to notify the Legal Office of the Department of Business Development in a case where there is evidence that the director of a company has breached his or her duties in the time before a petition is filed for corporate bankruptcy.

- The Department of Business Development should have the power to impose administrative penalties such as probation, administrative fines, public reprimands, temporary suspensions from acting as a director of a private limited company, and permanent disqualifications from acting as a director of a private limited company.

Reply

Having read the proposals made by Assistant Professor Adam, the Department of Business Development is unable to take these actions because it has no legal power to do so.

The law does have, for example, provisions concerning the qualifications required for a person to be a company director. However, there are no provisions on creating a blacklist of names of those who have a bad history (Blacklist). In the past, there have been situations in which the Anti-Money Laundering Office (AMLO) was required to send a list of names of those who had a bad history of money laundering, such as a history of defrauding the public, to the Department of Business Development in order to prevent these people from registering a new company. However, at this time, there is no law that gives power to the Department of Business Development to make an order preventing them from establishing a company.

If I am asked whether the Department of Business Development should have this power, my answer is yes, it should, as this would be of benefit to maintaining the peace and good order of the country and for preventing actions such as this.

In addition, in principle, this power should be the power of the Department of Business Development because it is the agency which has the duty for registration of companies, so it would be better than distributing this power to another agency, unless the exercise of these powers requires special expertise, such as investigation, in which case the powers should be granted to the agency which has the relevant expertise for performing that duty.

Therefore, all the considerations depend on the legal framework which must be clear from the outset as to the reasons, which must be in the legal framework, for punishment or inclusion on the Blacklist. For, if the law is not clear, this will have an impact on the consideration of the Department of Business Development, which will affect the duration and the number of personnel which are required to determine proceedings.

In practice, if I am asked whether the Department of Business Development will truly be able to implement these recommendations into practice or not, this is difficult to answer because it has never had powers such as these before, for example the power to examine the history of a person who comes to file a request to register a company.

However, in relation to the law prescribing the various penalties, this must be sufficiently plain and clear to allow the Department of Business Development to be able to really put it into practice and it must leave as little room for discretion as possible to reduce the risk of litigation in situations where registration is denied.

For example, if it is necessary to create a Blacklist, there must be a law that clearly states in which cases a person can be included on this Blacklist. For example, it should state the case of a person who has received a penalty according to a judgment in a case specifically relating to a dishonest property offence or a case of defrauding the public etc, which should relate to the qualifications and duties of being a company director.

If the law states criteria which are too broad, it will make it difficult for the Department of Business Development to operate, because prohibiting a person from registering a company with the objective of conducting business is a matter which infringes the rights of the people under the Constitution in the field of pursuing an occupation.

Concerning penalties of this nature, they exist already in other professions such as in the accounting profession which has a licence suspension or revocation process.

Regarding the proposed division of punishment into different levels, this should be done, because each offence does not have the same level of severity, and therefore should not carry the same level of punishment.

3. Do you agree with the proposal that a new law should be drafted to create a legal framework which specifies that a director of a private limited company has a duty to act in the interests of creditors, the legal framework to be recognised by the Department of Business Development and supported by ministerial regulations?

Reply

The law that specifies the rules on this matter should be the Civil and Commercial Code, which contains Section 1019 which provides, concerning the rights and responsibilities of the Registrar in carrying out its review, that "If an applicant for registration or a document subject to registration does not contain all the particulars required by this Title to be mentioned in it, or if any of the particulars mentioned in such application or document are contrary to law, or if any of the documents prescribed to be deposited with it are not produced, or if any other condition imposed by law is not complied with, the Registrar may decline to make any entry in the register until the application or document has been completed or modified or until the prescribed documents are produced, or until the condition is fulfilled."

Therefore, if the documents are complete, correct, and not contrary to this provision, the Department of Business Development must accept the registration and has no discretion to deny it, since at present there is no law that specifies the qualifications required for a person to apply for registration and for a person to be a company director.

When considering an application for registration, it is therefore necessary to consider this as the principal law and if there is a change in the law it will be necessary to develop other laws for consistency. For example, if there is a law which gives the power to other agencies, such as the AMLO in creating a list of persons with a bad history, it should also state that such persons are prohibited from being a director of a private limited company. However, in issuing the various laws, these should refer back to Section 1019 of the Civil and Commercial Code also.

At the present time, there are related rules regarding companies which are registered on the stock exchange in accordance with the Securities Exchange Act which specify the required qualifications of directors of public limited companies.

However, regarding private limited companies, the Department of Business Development has recommended amending the law on this for two reasons: first, problems arising from the conduct of work of officers, because at the present time officers do not have rights or duties in protecting creditors, and second, the private sector proposes amendments to the law, not with the objective of protecting creditors but aiming to make it easier to conduct business.

Therefore, the manner of proposing a new law or amending the law, it is necessary to look at the complete picture, the various state agencies must work together in an integrated manner to define the framework and objectives, together with the causes and behaviours which result in the imposition of penalties, and it is necessary to divide the different levels of penalty clearly in accordance with the types of behaviour. For example, in the case of repeated behaviour, the penalty should be more severe, such as the permanent disqualification of a person from being a company director.

In addition, two different issues must be considered: (1) If a person who wishes to become a director for the first time is a person with prohibited qualifications, how can the law prohibit him from becoming a company director? And (2), regarding a person who is already a director of a company, what will be the process in the law from removing him or her from that position? These need to be considered in detail, since this is removing a person's rights.

In addition, when considering the registration of persons with a bad history (Blacklist), there are issues to consider: registration of a large number of individuals is not easy, because there are tens of millions of people in Thailand who have the qualifications for being a director of a private company and there are there are billions of foreigners who would be able to register to be a director of a company established in Thailand.

4. Do you think it is appropriate for this dissertation to propose recommendations based on the concept of administrative sanctions in Chapter 8, Division 1 of the

Trusts for Transactions in the Capital Market Act BE 2550 (2007)? And, if it is not appropriate, should any other law be taken into consideration instead, or be considered in addition for the benefit of developing a legal framework?

Reply

There are many similar laws in Thailand, but it is often a matter of a group of people who have been granted a licence (License), which are small in number and is a group of people who have been registered before with the result that the government has information about these people.

However, in the case of directors of private limited companies, there are a large number of people, both Thais and foreigners, who can apply to be directors. Establishing a restriction of their right to make a registration may be difficult in practice.

Possible approaches include designating a group of people in the Blacklist of another agency, such as the AMLO, as a group of persons who are prohibited from being a director of a private company or applying other laws regarding personal qualifications; for example, that a person who has been declared bankrupt may not be a director of a company. However, there may be problems in practice, such as if a person becomes bankrupt after becoming a director, the Department of Business Development may have problems in becoming aware of such information because sometimes it is not notified.

Therefore, data will need to be integrated from various government agencies such as the Legal Execution Department and the Department of Provincial Administration.

However, there are problems in practice; for example, for company registrations before 26 September 2016, no identification number was required of those involved in the registration, making it impossible to verify information concerning whether or not such persons are bankrupts etc, and problems concerning incorrect information that has been registered, making verification difficult.

Each year, the Department of Business Development must register more than 75,000 businesses, approximately. Therefore, theoretically, the recommendations

proposed by this dissertation are possible, and this has been called for by many state agencies, which have a need for the Department of Business Development to have the power to not accept registrations from certain groups of people. These proposals therefore answer the issues that many agencies are raising and answer problems in society which must be addressed, and for which the Department of Business Development should have the power to screen personal history to prevent social problems including the problem of fraud against the public.

In addition, foreign guidelines may be considered, such as those of the Republic of Austria, which requires prior registration through the Chamber of Commerce first, or those of some countries which require prior registration through the court system. This is a preliminary examination of qualifications before being allowed to register a company and become a director.

- End -

บันทึกสรุปการสัมภาษณ์

คุณกิตติศักดิ์ โชติพนิชเศรษฐ์ นักวิชาการพาณิชย์ชำนาญพิเศษ กรมพัฒนาธุรกิจการค้า กระทรวงพาณิชย์

วันพุธที่ 23 กุมภาพันธ์ 2565 เวลา 13.30 – 15.30 น.

โดย ผู้ช่วยศาสตราจารย์ อาดัม รีคี

ล่าม: ผู้ช่วยศาสตราจารย์ ดร. สุรัชดา รีคี

1. ในภาพรวม ท่านมีความคิดเห็นอย่างไรต่อประเด็นปัญหาเรื่องการคุ้มครองเจ้าหนี้ไม่มีประกันของบริษัทเอกชนจำกัดในประเทศไทย มีปัญหาใดบ้างที่สมควรจะได้รับการแก้ไขโดยเร่งด่วน และกรมพัฒนาธุรกิจการค้าควรมีบทบาทหน้าที่อย่างไรบ้าง

ตอบ

ในทางปฏิบัติ งานหลักของกรมพัฒนาธุรกิจการค้าเป็นการจดทะเบียน ดังนั้นจึงไม่มีหน้าที่โดยตรงในการคุ้มครองเจ้าหนี้

แต่หากถามความเห็นว่า ควรมีการคุ้มครองหรือไม่ คำตอบคือเห็นด้วยในหลักการ เพราะผู้ก่อหนี้ก็ต้องมีการชำระหนี้ และกฎหมายไทยมีความหลากหลายในเรื่องระดับของเจ้าหนี้ ทำให้เจ้าหนี้กลุ่มที่ไม่มีประกันได้รับความคุ้มครองน้อยที่สุด

อย่างไรก็ดี ยังมีความไม่ชัดเจนในมาตราการคุ้มครอง ว่าควรจะทำอย่างไร เพราะอาจเกิดผลกระทบต่อเจ้าหนี้กลุ่มอื่น

2. ท่านเห็นด้วยกับข้อเสนอแนะเหล่านี้หรือไม่ เพราะเหตุใด และในความเห็นของท่าน ข้อเสนอแนะเหล่านี้จะสามารถนำไปปฏิบัติได้จริงหรือไม่

- เจ้าพนักงานพิทักษ์ทรัพย์จะต้องแจ้งต่อสำนักงานกฎหมายของกรมพัฒนาธุรกิจการค้า ในกรณีที่มีหลักฐานว่ากรรมการบริษัทได้กระทำผิดต่อหน้าที่ก่อนที่บริษัทจะได้ยื่นคำร้องต่อศาลขอให้นิติบุคคลล้มละลาย

- กรมพัฒนาธุรกิจการค้าควรมีอำนาจลงโทษทางปกครอง เช่น ภาคทัณฑ์, ปรับทางปกครอง, ตำหนิโดยเปิดเผยต่อสาธารณชน, สั่งพักการเป็นกรรมการของบริษัทเอกชนจำกัดใดๆเป็นการชั่วคราว, สั่งห้ามมิให้บุคคลนั้นเป็นกรรมการของบริษัทเอกชนจำกัดใดๆ เป็นการถาวร

ตอบ

จากการอ่านข้อเสนอที่ ผศ.อาดัม เสนอมา ตอนนี้กรมพัฒนาธุรกิจการค้าไม่สามารถทำเช่นนั้นได้ เพราะไม่มีกฎหมายให้อำนาจ

กฎหมายที่มี เช่น กฎหมายเรื่องคุณสมบัติของกรรมการบริษัท แต่ยังไม่มีเรื่องการขึ้นบัญชีเก็บบันทึกรายชื่อผู้ที่มีประวัติไม่ดี (Blacklist) ซึ่งที่ผ่านมาเคยมีกรณีที่สำนักงานป้องกันและปราบปรามการฟอกเงิน (ปปง.) ต้องการส่งรายชื่อของผู้มีประวัติไม่ดีด้านการฟอกเงิน เช่น ประวัติด้านการฉ้อโกงประชาชน มาให้กรมพัฒนาธุรกิจการค้าเพื่อป้องกันไม่ให้คนเหล่านี้จดทะเบียนตั้งบริษัทใหม่ แต่ในขณะนี้ไม่มีกฎหมายให้อำนาจกรมพัฒนาธุรกิจการค้าเกี่ยวกับการสั่งห้ามมิให้จดทะเบียน

หากถามว่ากรมพัฒนาธุรกิจการค้า ควรมีอำนาจดังนี้ไหม คำตอบคือควร เพื่อประโยชน์ในแง่การคุ้มครองความสงบสุขของประเทศ และการป้องกันการกระทำแบบนี้

นอกจากนี้ โดยหลักการ อำนาจดังนี้ก็สมควรจะเป็นอำนาจของกรมพัฒนาธุรกิจการค้า เพราะเป็นหน่วยงานที่มีหน้าที่จดทะเบียนจัดตั้งบริษัทอยู่แล้ว จึงดีกว่าการแยกอำนาจไปสู่หน่วยงานอื่น เว้นเสียแต่ว่าหากการใช้อำนาจเหล่านี้ต้องอาศัยความชำนาญเฉพาะด้าน เช่น การสืบสวนสอบสวน อาจจะต้องให้หน่วยงานอื่นซึ่งมีความชำนาญมากกว่าเป็นผู้ทำหน้าที่

ทั้งนี้การพิจารณาทุกอย่างจะขึ้นอยู่กับกรอบของกฎหมายที่จะต้องชัดเจนตั้งแต่ต้น ว่าเหตุใดบ้างจึงจะอยู่ในกรอบของกฎหมายที่จะลงโทษหรือถูก Blacklist เพราะหากกฎหมายไม่ชัดเจน จะกระทบต่อการพิจารณาของกรมพัฒนาธุรกิจการค้า ซึ่งจะส่งผลต่อระยะเวลา และจำนวนบุคลากรที่ต้องใช้ในการพิจารณาดำเนินการ

ในทางปฏิบัติ หากถามว่ากรมพัฒนาธุรกิจการค้าจะนำข้อเสนอเหล่านี้ไปปฏิบัติได้จริงหรือไม่ ในส่วนนี้ตอบยาก เพราะไม่เคยมีอำนาจเช่นนี้มาก่อน เช่น อำนาจในการตรวจสอบประวัติผู้ที่มายื่นคำร้องขอจดทะเบียนบริษัท

อย่างไรก็ดี ในส่วนของกฎหมายที่บัญญัติบทลงโทษต่างๆ จะต้องมีความชัดเจนมากเพียงพอ เพื่อให้กรมพัฒนาธุรกิจการค้าสามารถนำไปปฏิบัติได้จริง และจำกัดการใช้ดุลพินิจให้น้อยที่สุด เพื่อลดความเสี่ยงต่อการถูกฟ้องร้องในกรณีที่ปฏิเสธการจดทะเบียน

ตัวอย่างเช่น หากต้องการให้มีการขึ้นบัญชีรายชื่อผู้ที่มีประวัติไม่ดี (Blacklist) ก็จะต้องมีกฎหมายที่ระบุเหตุให้ชัดเจน ว่ากรณีใดบ้างที่จะสามารถนำรายชื่อบุคคลเข้าสู่บัญชีรายชื่อนี้ได้ เช่น อาจระบุเหตุกรณีเป็นบุคคลที่ต้องโทษตามคำพิพากษาเฉพาะคดีที่เกี่ยวกับทรัพย์โดยทุจริต หรือคดีฉ้อโกงประชาชน เป็นต้น ซึ่งควรจะมีความเกี่ยวข้องกับคุณสมบัติและหน้าที่ของการเป็นกรรมการบริษัท

หากกฎหมายกำหนดเกณฑ์ที่กว้างมากเกินไป ก็จะทำให้กรมพัฒนาธุรกิจการค้าปฏิบัติงานได้ยาก เพราะการห้ามมิให้บุคคลจดทะเบียนบริษัทเพื่อวัตถุประสงค์ในการทำธุรกิจ เป็นเรื่องของการละเมิดสิทธิของประชาชนตามรัฐธรรมนูญในด้านการประกอบอาชีพ

เรื่องการลงโทษในลักษณะนี้ มีอยู่แล้วในวิชาชีพอื่นๆ เช่น วิชาชีพด้านการบัญชี ซึ่งมีการพักใช้ใบอนุญาต หรือ เพิกถอนใบอนุญาต

ในส่วนของการแบ่งโทษตามระดับที่เสนอมานี้ น่าจะใช้ได้ เพราะแต่ละความผิดอาจมีความรุนแรงไม่เท่ากันจึงควรจะมีระดับการลงโทษที่ไม่เท่ากันด้วย

3. ท่านเห็นด้วยกับข้อเสนอแนะดังต่อไปนี้หรือไม่ ว่า ควรมีการร่างพระราชบัญญัติฉบับใหม่ ที่จะสร้างกรอบกฎหมายที่จะกำหนดหน้าที่ของกรรมการบริษัทเอกชนจำกัดในการกระทำการเพื่อประโยชน์ของเจ้าหนี้ ซึ่งกรอบกฎหมายนี้ควรจะได้รับการยอมรับจากกรมพัฒนาธุรกิจการค้า และควรมีการออกกฎกระทรวงเพื่อรองรับประเด็นข้อเสนอแนะนี้

ตอบ

กฎหมายที่จะกำหนดหลักเกณฑ์ในเรื่องนี้ ควรเป็นประมวลกฎหมายแพ่งและพาณิชย์ เพราะมีมาตรา 1019 ซึ่งระบุเรื่องอำนาจหน้าที่ของนายทะเบียนในการตรวจพิจารณาไว้แล้วว่า ถ้าคำขอจดทะเบียนหรือเอกสารซึ่งต้องจดทะเบียนไม่มีรายการบริบูรณ์ตามที่บังคับไว้ในลักษณะนี้ ว่าให้จดแจ้งก็ดี หรือถ้ารายการอันใดซึ่งจะแจ้งในคำขอหรือในเอกสารนั้นขัดกับกฎหมายก็ดี หรือถ้าเอกสารใดซึ่งกำหนดไว้ว่าให้ส่งด้วยกันกับคำขอจดทะเบียนยังขาดอยู่มิได้ส่งให้ครบก็ดี หรือถ้าไม่ปฏิบัติตาม

เงื่อนไขข้ออื่นซึงกฎหมายบังคับไว้ก็ดี นายทะเบียนจะไม่ยอมรับจดทะเบียนก็ได้ จนกว่าคำขอจดทะเบียนหรือเอกสารนั้นจะได้ทำให้บริบูรณ์หรือแก้ไขให้ถูกต้อง หรือได้ส่งเอกสารซึ่งกำหนดไว้นั้นครบทุกสิ่งอันหรือได้ปฏิบัติตามเงื่อนไขข้อนั้นแล้ว

ดังนั้น หากมีเอกสารครบถ้วน ถูกต้อง ไม่ขัดกับมาตรานี้ กรมพัฒนาธุรกิจการค้าจะต้องรับจดทะเบียน และไม่มีดุลพินิจให้ปฏิเสธ เพราะในปัจจุบันไม่มีกฎหมายกำหนดคุณสมบัติของบุคคลที่ยื่นขอจดทะเบียน และบุคคลที่จะเป็นกรรมการบริษัท

การพิจารณาคำขอจดทะเบียน จึงต้องพิจารณากฎหมายในส่วนนี้เป็นหลัก และหากจะมีการแก้ไขปรับปรุงกฎหมาย ก็ควรจะต้องพัฒนากฎหมายอื่นๆ ให้สอดคล้องกัน เช่น หากมีกฎหมายที่ให้อำนาจหน่วยงานอื่นเช่น ปปง. ในการสร้างบัญชีรายชื่อบุคคลที่มีประวัติไม่ดี ก็ควรระบุด้วยว่า ห้ามบุคคลเหล่านั้นเป็นกรรมการบริษัทเอกชน อย่างไรก็ตาม การออกกฎหมายต่างๆ ควรจะต้องล้อกลับมาที่ประมวลกฎหมายแพ่งและพาณิชย์มาตรา 1019 นี้ด้วย

ในขณะนี้มีหลักการที่เกี่ยวข้อง ในส่วนของบริษัทที่จดทะเบียนในตลาดหลักทรัพย์ ตามพระราชบัญญัติหลักทรัพย์และตลาดหลักทรัพย์ ซึ่งมีการกำหนดคุณสมบัติบางอย่างของกรรมการบริษัทมหาชนจำกัด

อย่างไรก็ดี ในส่วนของบริษัทเอกชน กรมพัฒนาธุรกิจการค้าเคยเสนอขอแก้กฎหมายในส่วนนี้ ซึ่งมีเหตุผลจาก 2 กลุ่ม คือ หนึ่ง ปัญหาจากการปฏิบัติงานของเจ้าหน้าที่ เพราะในขณะนี้เจ้าหน้าที่ไม่มีอำนาจหน้าที่ในการคุ้มครองเจ้าหนี้ และ สอง ภาคเอกชนเสนอให้มีการแก้ไขกฎหมาย ซึ่งจะไม่ได้มุ่งคุ้มครองเจ้าหนี้ แต่จะมุ่งให้ความสะดวกในการทำธุรกิจมากขึ้น

ดังนั้น วิธีการเสนอกฎหมายใหม่ หรือแก้ไขกฎหมาย จะต้องดูในภาพรวม หน่วยงานต่างๆ ของรัฐจะต้องทำงานร่วมกันแบบบูรณาการ เพื่อกำหนดกรอบและเป้าหมาย รวมทั้งเหตุและพฤติกรรมที่ก่อให้เกิดผลคือการลงโทษ และจะต้องแบ่งระดับการลงโทษที่ชัดเจนตามระดับพฤติกรรม เช่น การกระทำผิดซ้ำซาก ควรมีการลงโทษที่เข้มข้นขึ้น เช่น การเพิกถอนสิทธิในการเป็นกรรมการบริษัท

นอกจากนี้ จะต้องพิจารณาในประเด็นที่ต่างกันเป็น 2 กรณี คือ (1) หากบุคคลที่ต้องการเข้ามาเป็นกรรมการในครั้งแรก เป็นบุคคลที่มีคุณสมบัติต้องห้าม กฎหมายจะห้ามเขาในการเข้ามาเป็นกรรมการบริษัทได้อย่างไร และ (2) ในส่วนของบุคคลที่เป็นกรรมการบริษัทอยู่แล้ว กฎหมายจะมี

กระบวนการในการกำจัดออกจากตำแหน่งอย่างไร ซึ่งต้องพิจารณาให้ละเอียด เพราะเป็นการเพิกถอนสิทธิของบุคคล

นอกจากนี้ เมื่อพิจารณาเรื่องการขึ้นทะเบียนบุคคลที่มีประวัติไม่ดี (Blacklist) ก็มีประเด็นที่ต้องพิจารณาว่า การขึ้นทะเบียนบุคคลเป็นจำนวนมาก ไม่ใช่เรื่องง่าย เพราะบุคคลที่มีคุณสมบัติในการเป็นกรรมการบริษัทเอกชน มีหลายสิบล้านคนในประเทศไทย และยังมีชาวต่างชาติอีกหลายพันล้านคนที่สามารถขอจดทะเบียนเป็นกรรมการบริษัทที่จัดตั้งขึ้นในประเทศไทยได้

4. ท่านคิดว่า การที่ดุษฎีนิพนธ์นี้ได้สร้างข้อเสนอแนะซึ่งอิงตามแนวคิดเรื่องการลงโทษทางปกครองในหมวดที่ 8 ส่วนที่ 1 แห่งพระราชบัญญัติทรัสต์เพื่อธุรกรรมในตลาดทุน พ.ศ. ๒๕๕๐ มีความเหมาะสมหรือไม่ และหากไม่เหมาะสม ควรนำกฎหมายฉบับอื่นใดมาพิจารณาแทน หรือพิจารณาประกอบ เพื่อประโยชน์ในการพัฒนากรอบกฎหมาย

ตอบ

กฎหมายลักษณะเดียวกันนี้ในประเทศไทยมีอยู่หลายฉบับ แต่มักเป็นเรื่องของกลุ่มคนที่ได้รับในอนุญาต (License) ซึ่งมีจำนวนน้อย และเป็นกลุ่มบุคคลที่ได้รับการขึ้นทะเบียนก่อนแล้ว ทำให้ทางราชการมีข้อมูลเกี่ยวกับบุคคลเหล่านี้

แต่ในกรณีของการเป็นกรรมการบริษัทเอกชน มีจำนวนบุคคลทั้งคนไทยและคนต่างชาติที่สามารถขอเป็นกรรมการได้เป็นจำนวนมาก การสร้างเงื่อนไขจำกัดสิทธิโดยการขึ้นทะเบียนจึงอาจเป็นไปได้ยากในทางปฏิบัติ

แนวทางที่อาจเป็นไปได้ เช่น การกำหนดให้กลุ่มบุคคลที่อยู่ใน Blacklist ของหน่วยงานอื่น เช่น ปปง. เป็นกลุ่มบุคคลที่มีลักษณะต้องห้ามไม่ให้เป็นกรรมการบริษัทเอกชนด้วย หรือ ใช้กฎหมายอื่นๆเกี่ยวกับคุณสมบัติบุคคล เช่น ผู้ที่จะเป็นกรรมการบริษัทจะต้องไม่ใช่บุคคลล้มละลาย แต่อาจมีปัญหาในทางปฏิบัติ เช่น หากเป็นบุคคลล้มละลายหลังจากที่ได้เป็นกรรมการบริษัทแล้ว กรมพัฒนาธุรกิจการค้าอาจมีปัญหาในการรับทราบข้อมูล เพราะบางครั้งก็ไม่ได้รับแจ้ง

ดังนั้น จึงต้องมีการบูรณาการข้อมูลจากหน่วยงานต่างๆของรัฐ เช่น กรมบังคับคดี กรมการปกครอง

อย่างไรก็ดี มีปัญหาในทางปฏิบัติตามมา เช่น การจดทะเบียนบริษัท ก่อนวันที่ 26 กันยายน 2559 ไม่มีการเก็บเลขประจำตัวประชาชนของผู้ที่เกี่ยวข้องกับการจดทะเบียน ทำให้ตรวจสอบข้อมูลไม่ได้ว่าผู้นั้นเป็นบุคคลล้มละลาย เป็นต้น หรือ ปัญหาเรื่องข้อมูลในทะเบียนผิดพลาด ส่งผลให้ตรวจสอบยาก

ในแต่ละปี กรมพัฒนาธุรกิจการค้า จะต้องจดทะเบียนธุรกิจเป็นจำนวนมาก กว่า 75,000 ราย โดยประมาณ ฉะนั้น ในทางทฤษฎี แนวทางของข้อเสนอของดุษฎีนิพนธ์ฉบับนี้ มีความเป็นไปได้ และยังเป็นข้อเรียกร้องของหลายหน่วยงานของรัฐ ที่ต้องการให้กรมพัฒนาธุรกิจการค้ามีอำนาจในการไม่รับจดทะเบียนบุคคลบางกลุ่ม ข้อเสนอเหล่านี้จึงตอบโจทย์ปัญหาที่หลายหน่วยงานเรียกร้อง และยังตอบโจทย์ปัญหาสังคมที่ควรจะต้องแก้ไข ซึ่งกรมพัฒนาธุรกิจการค้า ควรมีอำนาจในการคัดกรองประวัติบุคคล เพื่อป้องกันปัญหาสังคม รวมทั้งปัญหาการฉ้อโกงประชาชน

นอกจากนี้ อาจพิจารณาแนวทางของต่างประเทศ เช่น สาธารณรัฐออสเตรีย ซึ่งกำหนดให้มีการขึ้นทะเบียนผ่าน Chamber of Commerce ก่อน หรือบางประเทศก็กำหนดให้ขึ้นทะเบียนผ่านระบบศาลก่อน เป็นการตรวจสอบคุณสมบัติเบื้องต้นก่อนจะที่อนุญาตให้จดทะเบียนจัดตั้งบริษัทและเป็นกรรมการได้

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BIOGRAPHY

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2008–9: BPP Professional Education, London: Graduate Diploma in Law (Commendation); Legal Practice Course (Distinction). Admitted as a Solicitor in England and Wales in 2011.

2005: The Queen's College, University of Oxford: Literae Humaniores (Classics) B.A. Hons, M.A. (Oxon)

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Awards

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